S. HRG. 100-119

CREDIT CARD DISCLOSURE ACTS

HEARING

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

S. 241

TO AMEND THE TRUTH IN LENDING ACT

S. 242

TO AMEND THE TRUTH IN LENDING ACT TO IMPOSE A CEILING ON CREDIT CARD INTEREST RATES

S. 616

TO AMEND THE TRUTH IN LENDING ACT TO PROVIDE FOR MORE DETAILED AND UNIFORM DISCLOSURE BY CREDIT CARD ISSUERS WITH RESPECT TO INFORMATION ON INTEREST RATES AND OTHER FEES WHICH MAY BE INCURRED BY CONSUMERS THROUGH THE USE OF ANY CREDIT CARD, AND FOR OTHER PURPOSES

S. 647

TO ESTABLISH A LIMITATION ON THE RATES OF INTEREST WHICH MAY BE IMPOSED ON CREDIT CARD ACCOUNTS, AND TO PROVIDE FOR MORE DETAILED DISCLOSURES BY CREDIT CARD ISSUERS IN APPLICATION FOR CREDIT CARDS.

APRIL 21, 1987

Printed for the use of the Committee on Banking, Housing, and Urban Affairs

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CREDIT CARD DISCLOSURE ACTS

TUESDAY, APRIL 21, 1987

U.S. SENATE,
SUBCOMMITTEE ON CONSUMER AFFAIRS,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The subcommittee met at 9:35 a.m., in room SD-538, Dirksen Senate Office Building, Senator Christopher J. Dodd (chairman of the subcommittee) presiding.

Present: Senators Dodd, Proxmire, Sasser, Shelby, and Gramm.

Also present: Senator Exon.

OPENING STATEMENT OF SENATOR DODD

Senator DODD. The Consumer Affairs Subcommittee of the Senate Banking, Housing, and Urban Affairs Committee will come to order.

This morning we are going to be conducting a hearing on credit card interest rates. This subcommittee will investigate a mystery—a mystery of how credit cards can defy the laws of gravity by actually rising at a time when all other interest rates have plummeted. Even with the recent slight increases in interest rates, the prime rate particularly, the Fed discount rate and the rate of the 30-year mortgages, they stand at about half of what they were at their peak 6 years ago.

During that same period of time, however, not only have credit interest rates failed to fall, they have actually risen. Moreover, while there has been some recent price competition among card issuers, the rates for four of the six largest issuers of VISA and Mastercards have remained above 19 percent, while the two others only recently dipped below 18 percent.

Not surprisingly, the failure of credit card rates to drop has resulted in significant profits for the issuers. Whereas, credit card profits were often slim or nonexistent during the 1970's, for the last 2 years they have been the banks' most profitable form of loan.

It is important for this subcommittee to try and determine why competition doesn't appear to be working because Americans have come to rely on credit cards to such degree that even a point's decline in interest charges could save consumers $1 billion a year in interest charges and certainly with consumer debt growing at the rate it is, obviously this could result in a profound and significant decrease in this growing problem.

Today, there are some 105.5 million people who own some 731 million credit cards. In mid-1986, consumers owed credit card issuers in excess of $152 billion. Some 36.9 million people with VISA

and Mastercards used those cards for revolving credit, with each owing an average in excess of $1,900.

As you can see, that translates into interest being paid on about $70.8 billion where a point or two of interest can turn into real money rather quickly.

This hearing will try to get to the bottom of why competition doesn't seem to be working so we can devise a solution. In these hearings we will be focusing on two different kinds of proposed solutions—the interest rate caps and the disclosure of relevant terms and conditions at the time a credit card issuer solicits members.

In the past, I have been reluctant to support credit card ceilings. While they are a simple solution, I happen to believe they are a wrong solution to a very complicated problem. Nevertheless, if we try disclosure and the rates do not come down, we may well be sitting here 1 or 2 years from now seriously considering rate cap legislation.

I would first like to turn to the chairman of the Banking Committee, Senator Proxmire, for any opening statements.

Senator PROXMIRE. I have no opening statement, Mr. Chairman.

Senator DODD. Senator Gramm.

Senator GRAMM. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR GRAMM

Senator GRAMM. I would first like to note that there is some paradox that we are here talking about usury limits, something that was very much debated in the Middle Ages and decided and dispatched during that period. I guess it is living proof that there is no permanent enlightenment, that no bad idea based on ignorance or prejudice ever dies. It simply hunkers down waiting for some dark moment when it raises its head again full-blown to try to deceive people and in the process, promote inefficiency and poverty and hardship.

It's like the gods of the copybook headings in the Kipling poem that "water wets and fire burns and the fool's burned finger goes back to the fire."

It seems we have to learn over and over and over again that markets work; that Government does not; that Government promotes inefficiency, denies access to markets and hurts the consumer and the worker all to the benefit of special interests, often based not on any real understanding of the problem but based instead on some degree of ignorance or prejudice. And so we begin the debate again.

Thank you, Mr. Chairman.

Senator DODD. Senator Shelby.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Mr. Chairman, thank you for your leadership in holding this hearing.

Today, we are focusing on an issue that affects millions of consumers—that is, the credit card interest rates and disclosure of credit card related information.

I have a chart here that shows how the interest rates in credit card rates have stayed way up and the other rates from the T-bills,

the 6-months bill, the prime rate—everything has gone down from 1981 through 1987. It's been said that a picture is worth a thousand words here. In that same vein, Mr. Chairman, the chart that I have here today may be worth a thousand questions if you look at it in detail.

[The chart referred to follows:]

But most of the important questions I think for me and the other consumers is why there is such a disparity between other interest rates and credit card interest rates.

Over the past 5 years we have witnessed a dramatic decline in the prime rate, the Federal Reserve discount rate, the 6-month T-bill rate, and the 24-month personal loan rate. Yet, the interest rates on credit cards remain "fixed" at an average of 18 percent. The rate on some cards is as high as 22 percent.

Why is the cost of money vastly different for credit card issuers than others? I think that that question has been answered by some people, but perhaps not to the consumers' satisfaction.

What has been called one of the most profitable lines of service for banks may actually be one of the most outrageous abuses of American consumers. Maybe there is a justified reason for this gap. I certainly look forward to an explanation here today.

Today, we are considering several bills which would impose a cap on credit card interest rates. I would prefer leaving the determination of prices and rates to a competitive marketplace, if in fact a true marketplace environment exists and provided that the consumer has the information and the opportunity to make informed decisions.

While a cap may certainly not be the answer, it is obvious that the marketplace in the credit card industry is not working today. I think this marketplace could use a healthy dose of competition from what, who, and where we're not sure.

Another element of the credit card marketplace is the lack of understandable information with which the consumer can make a rational decision about the card he or she needs.

I have some credit card bills here somewhere—here. I doubt whether many consumers fully understand what this language on the back here really means. It says, "For Pennsylvania residents, for Massachusetts residents, general information, CBA accounts only, billing inquiries, average daily balance calculations."

As a cure, I think we have got to move forward and see what the problem is. I firmly support my colleagues on the committee to require disclosure of the annual fee, the grace period, the finance charge, and any penalties or fees which may be applied. This information should be made available at the time of solicitation and not after the card has been received.

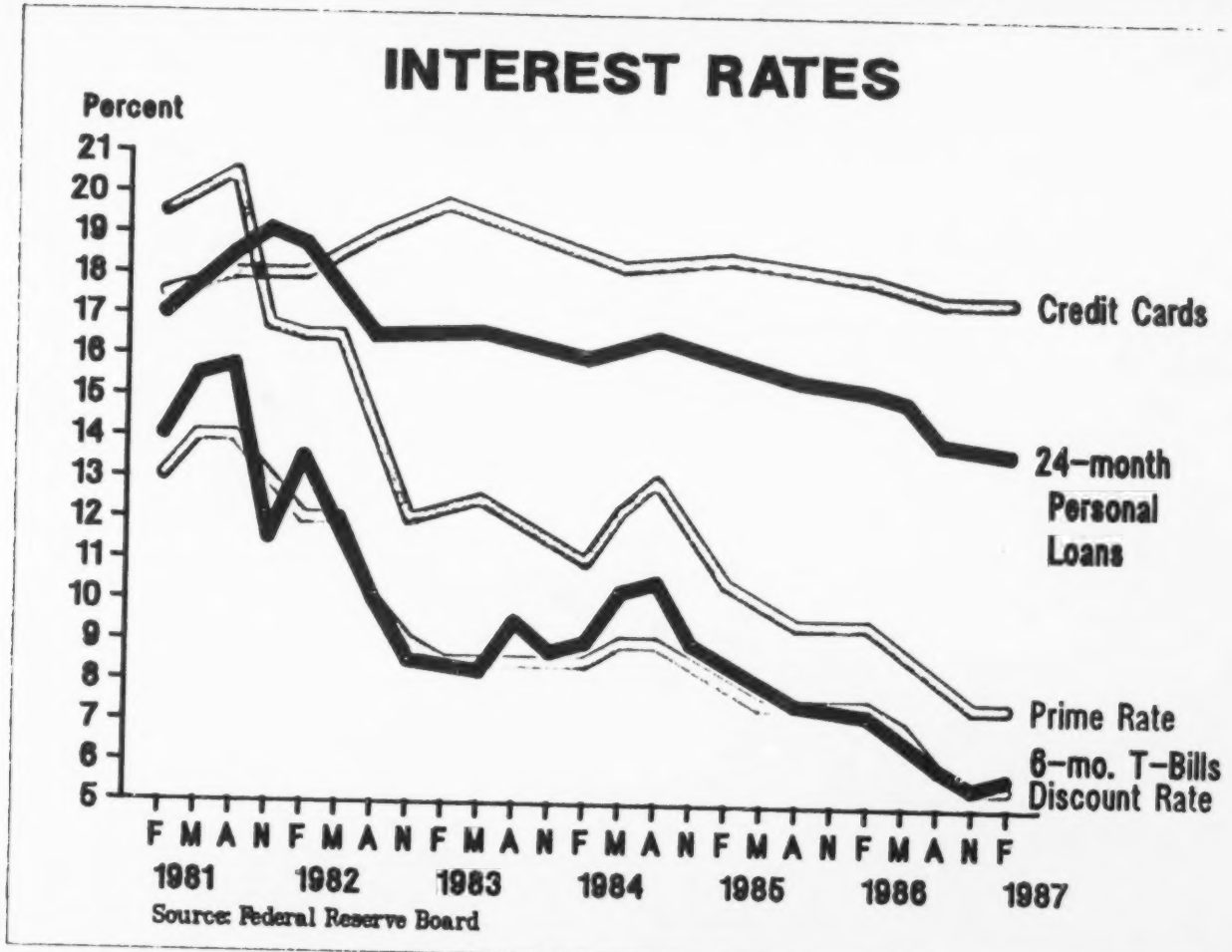
I welcome our witnesses here today and again, Mr. Chairman, I commend you for holding the hearing.

Senator DODD. Thank you, Senator Shelby.

Very briefly, Senator D'Amato was going to be here this morning but he's attending a ceremony at his alma mater in the State of New York and will try and be down here later this afternoon, but wanted to have his statement inserted in the record and express his regrets to the witnesses for not being able to be with us.

STATEMENT BY SENATOR ALFONSE M. D'AMATO

Senator D'AMATO. Mr. Chairman, I want to welcome our distinguished panel of witnesses to the Banking Committee this morning. The high interest rates charged by issuers of credit cards must be curbed. In addition, simple fairness dictates that consumers be


INTEREST RATES
Percent
21
20
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14
13
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8
7
6
5
F M A N F M A N F M A N F M A N F M A N F M A N F
1981
1982
1983
1984
1985
1986
1987
Credit Cards
24-month Personal Loans
Prime Rate
6-mo. T-Bills
Discount Rate
Source: Federal Reserve Board

given access to all material terms at the time an application for a credit card is made.

My feelings about credit card interest rates are no secret. At a time when the cost of funds has fallen dramatically, the savings have not been passed on to the consumer and reflected in the rates that credit card holders are charged. Although the prime rate has dropped to 7.75 percent, the discount rate has fallen to 5.5 percent, and mortgage rates have dipped below 9 percent, the average rate charged on credit cards remains extraordinarily high—17.82 percent. It is unconscionable that some issuers charge credit card interest rates as high as 22.2 percent when their cost of funds is 15 points lower.

The legislation that I have proposed, the Credit Card Holder Protection Act, S. 242, and the Credit Card Disclosure Act of 1987, S. 241, will go a long way to remedy this situation. These bills impose a ceiling on credit card interest rates at four points over the IRS refund rate—this ceiling currently would be 12 percent—and require card issuers to make a full disclosure of interest charges, annual fees, and other material terms on all credit card applications. In addition, S. 241 would require the issuer of any credit card to submit this information quarterly to the Federal Reserve Board, which would make it available to the public upon request.

This committee held hearings on this issue during the 99th Congress. Since that time, some issuers have reduced their rates. Most recently, American Express announced the introduction of its Optima card which will carry an initial interest rate of 13.5 percent. However, most issuers unfortunately continue to charge higher rates.

Mr. Chairman, the time has arrived for action. Issuers of credit cards have had ample time to reflect on their current policies, and to make reasonable adjustments. It seems that most have chosen to ignore Congress' concern for high interest rates and proceed with their great American ripoff. I am encouraged by a House Banking Subcommittee action on similar legislation.

I appreciate and look forward to the testimony which we are about to hear. I hope that within the next few weeks we will be able to move toward a markup of credit card legislation.

We are going to follow some rules in that I would ask all the witnesses to try and keep their remarks relatively brief. We have all of your statements. If we haven't received it it will be made part of the record. If you have a prepared statement, try and paraphrase that if you can so that we can get to questions. I find that to be a far more profitable part of a hearing, rather than just listening to testimony.

[Copies of proposed bills follow:]

II

100TH CONGRESS
1ST SESSION

S. 241

To amend the Truth in Lending Act.

IN THE SENATE OF THE UNITED STATES

JANUARY 6, 1987

Mr. D'AMATO introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Truth in Lending Act.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Credit Card Disclosure Act of 1987".

SEC. 2. DISCLOSURE IN CREDIT CARD APPLICATIONS.

Section 127 of the Truth in Lending Act (15 U.S.C. 1637) is amended by adding at the end thereof the following:

"(c) In any application to open any credit card account, or in any solicitation which offers to open such an account without the need for an application to be completed, a card issuer shall disclose—

"(1) the annual percentage rate used to determine a finance charge on any balances;

"(2) the time period (if any) within which any credit extended by means of that credit card may be repaid without incurring a finance charge, or if no such time period is provided, the creditor shall disclose such fact;

"(3) any minimum or fixed amount imposed as a monthly or other periodic finance charge; and

"(4) any annual or other charge of fee required to be paid for the use of the credit card account.".

SEC. 3. REPORTING TO THE BOARD OF GOVERNORS.

Section 136 of the Truth in Lending Act (15 U.S.C. 1646) is amended—

(1) by redesignating subsection (b) as subsection (c);

(2) by inserting after subsection (a) the following new subsection:

"(b) The issuer of any credit card shall submit quarterly to the Board the information required to be disclosed by section 127(c). The Board shall make such information available to the public upon request, and shall report such information annually to Congress."; and

(3) by striking out "subsection (a)" in subsection (c), as redesignated, and inserting in lieu thereof "subsections (a) and (b)".

SECTION-BY-SECTION ANALYSIS

Currently, section 127 of the Truth in Lending Act (15 U.S.C. 1637) requires disclosure of certain information regarding an open-end consumer credit plan before opening an account. This has been interpreted by the Federal Reserve Board in 12 C.F.R. 226.5(b)(1) as requiring disclosure "before the first transaction is made under the plan." Thus, disclosure is not required in the application. Section 2 of this bill requires additional disclosure in an application for a credit card, as it is at the application stage that most consumers make the decision to obtain a credit card. However, less information is required in the application than must currently be disclosed before the first transaction, since the goal of such disclosure is to permit easy comparisons between credit card plans.

The information to be disclosed pursuant to this amendment must meet the requirements to section 136 of the Truth in Lending Act (15 U.S.C. 1646), which requires information to be disclosed "clearly and conspicuously, in accordance with regulations of the Board." Moreover, that section also requires the terms "annual percentage rate" and "finance charge" to be more conspicuous than other information except that relating to the identity of the creditor.

Under section 136 of the Truth in Lending Act (15 U.S.C. 1646), the Board is authorized to collect, publish, and provide limited dissemination to the public of annual percentage rates charged for nonsale credit by creditors, and it may require such creditors to submit the information to the Board. Section 3 amends this provision by adding a requirement that credit card issuers submit the annual percentage rate, along with grace periods, minimum finance charges, and annual fees, to the Board, which will make such information available to the public upon request and in an annual report to Congress. This will provide a means for better disclosure of information regarding credit cards, contributing to the efficient working of the market.

○

II

100TH CONGRESS
1ST SESSION

S. 242

To amend the Truth in Lending Act to impose a ceiling on credit card interest rates.

IN THE SENATE OF THE UNITED STATES

JANUARY 6, 1987

Mr. D'AMATO introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Truth in Lending Act to impose a ceiling on credit card interest rates.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Credit Cardholder Protection Act".

SEC. 2. Section 107 of the Truth in Lending Act (15 U.S.C. 1606) is amended by adding at the end thereof the following:

"(f) The annual percentage rate applicable to an extension of credit obtained by use of a credit card may not exceed by more than 4 percentage points the ratio established under

section 6621 of the Internal Revenue Code of 1954, as determined by the Board.".

SEC. 3. Section 127 of the Truth in Lending Act (15 U.S.C. 1637) is amended by adding at the end thereof the following:

"(c) A card issuer shall clearly and conspicuously disclose on initial applications for a credit card—

"(1) the annual percentage rate applicable to extensions of credit by means of that credit card or the means for determining that rate; and

"(2) any annual or other fee imposed for the issuance or use of that credit card.

Each card issuer shall report monthly to the Board for publication the average annual percentage rate and the amount of any annual or other fee applicable during the preceding month to its credit card accounts.".

SEC. 4. Section 703(b) of the Equal Credit Opportunity Act (12 U.S.C. 1691b(b)) is amended—

(1) by inserting "(1)" after "(b)"; and

(2) by adding at the end thereof the following:

"(2) The Council shall transmit annually to the Congress a report that describes and analyzes the costs and risks involved in issuing credit cards, the percentage of credit card customers that have their cards revoked for non-payment or delinquent payments, revenues derived from interest rates

charged by credit card issuers, revenues derived from annual fees and application fees, and the impact that the provisions of section 107(f) of this Act will have on consumers and card issuers.".

○

II

100TH CONGRESS
1ST SESSION

S. 616

To amend the Truth in Lending Act to provide for more detailed and uniform disclosure by credit card issuers with respect to information on interest rates and other fees which may be incurred by consumers through the use of any credit card, and for other purposes.

IN THE SENATE OF THE UNITED STATES

FEBRUARY 26, 1987

Mr. DODD (for himself and Mr. PROXMIRE) introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

---

A BILL

To amend the Truth in Lending Act to provide for more detailed and uniform disclosure by credit card issuers with respect to information on interest rates and other fees which may be incurred by consumers through the use of any credit card, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Full Credit Card Cost Disclosure Act".

SEC. 2. CREDIT CARD COST DISCLOSURE REQUIREMENTS.

(a) DISCLOSURE REQUIRED IN SOLICITATIONS BY CREDIT CARD ISSUERS AND IN APPLICATIONS FOR CREDIT CARDS.—Section 127 of the Truth In Lending Act (15 U.S.C. 1637) is amended by adding at the end thereof the following new subsections:

"(c) DISCLOSURE IN CREDIT CARD APPLICATIONS AND SOLICITATIONS.—

"(1) IN GENERAL.—An application or solicitation to open a credit card account for any person under an open end consumer credit plan shall disclose the following information, to the extent applicable:

"(A) The annual percentage rate or rates applicable to extensions of credit under such credit plan or, in the case of an extension of credit which is subject to a variable rate, the means for determining that rate, and where more than one rate applies, the range of balances to which each rate is applicable.

"(B) Any annual or other fee or charge imposed for the issuance or use of a credit card.

"(C) The period within which any credit extended under such credit plan must be repaid to avoid incurring a finance charge, and, if no such period is offered, such fact shall be clearly stated.

"(D) A statement of how the balance on which the finance charge is computed is determined.

"(2) SPECIAL RULE FOR 'TAKE-ONE' APPLICATIONS.—In the case of applications described in paragraph (1) which are distributed to commercial retail establishments and made available to the public in such establishments, such applications meet the requirements of paragraph (1) if—

"(A) the information required to be included in such applications under paragraph (1) is included and is accurate as of the date the applications are distributed to the commercial retail establishments;

"(B) each application contains a reference to the date on which the application is prepared for distribution to a commercial retail establishment; and

"(C) each application contains a statement, in a conspicuous and prominent location on the application, that—

"(i) the information contained in the application is subject to change; and

"(ii) the applicant should contact the creditor for information on any change in the

information contained in the application since the application was distributed.

"(3) SPECIAL RULE FOR CHARGE CARDS.—

"(A) IN GENERAL.—Any application or solicitation for a charge card shall disclose, clearly and conspicuously, the following information, to the extent applicable:

"(i) Any annual or other fee or charge imposed for the issuance or use of a charge card.

"(ii) A statement that charges incurred by use of the charge card are due and payable upon receipt of and in accordance with a periodic statement of charges.

"(B) ISSUERS OF CHARGE CARDS WHICH PROVIDE ACCESS TO OPEN END CONSUMER CREDIT PLANS.—If a charge card permits the card holder to receive an extension of credit under an open end consumer credit plan which is not maintained by the charge card issuer, the charge card issuer may provide the information described in subparagraph (A) in lieu of the information required to be provided under paragraph (1) or (2) with respect to any credit extended under such plan, if the information required to be disclosed

under paragraph (1) is provided to the charge card holder by the creditor which maintains such open end consumer credit plan before the first extension of credit under such plan.

"(C) CHARGE CARD DEFINED.—For the purposes of this subsection, the term 'charge card' means a card, plate, or other single credit device that may be used from time to time to obtain credit which is not subject to a finance charge.".

(b) CERTAIN INFORMATION REQUIRED TO BE DISCLOSED IN TABULAR FORM.—Section 122 of such Act (15 U.S.C. 1632) is amended—

(1) in the third sentence of subsection (a), by striking out "Regulations" and inserting in lieu thereof "Except as provided in subsection (c), regulations"; and

(2) by adding at the end thereof the following new subsection:

"(c) TABULAR FORMAT REQUIRED FOR DISCLOSURES UNDER SECTION 127(c).—

"(1) IN GENERAL.—Any information which is required to be disclosed under paragraph (1) or (2) of section 127(c) in any solicitation application shall be—

"(A) disclosed in the precise form and manner which the Board shall prescribe by regulations; and

"(B) placed in a conspicuous and prominent location on any application, solicitation, or other document or paper with respect to which such disclosure is required.

"(2) TABULAR FORMAT.—

"(A) FORM OF TABLE TO BE PRESCRIBED.—In the regulations prescribed under paragraph (1)(A) of this subsection, the Board shall require that the information referred to in paragraph (1) shall, to the extent the Board determines to be practicable and appropriate, be disclosed in the form of a table which—

"(i) contains clear and concise headings for each item of such information; and

"(ii) provides a clear and concise form for stating each item of information required to be disclosed under each such heading.

"(B) BOARD DISCRETION IN PRESCRIBING ORDER AND WORDING OF TABLE.—In prescribing the form of the table under subparagraph (A), the Board may—

"(i) list the items required to be included in the table in a different order than the order in which such items are set forth in paragraph (1) or (2) of section 127(c); and

"(ii) subject to subparagraph (C), employ terminology which is different from the terminology which is employed in section 127(c) if such terminology conveys substantially the same meaning.

"(C) GRACE PERIOD.—Either the heading or the statement under the heading which relates to the time period referred to in section 127(c)(1)(D) shall contain the term 'grace period'.".

(c) COORDINATION WITH OTHER LAWS.—Section 111 of the Truth in Lending Act (15 U.S.C. 1610) is amended—

(1) in subsection (a)(1), by striking out "Chapters 1, 2, and 3" and inserting in lieu thereof "Except as provided in subsection (e), chapters 1, 2, and 3"; and

(2) by adding at the end thereof the following new subsection:

"(e) CERTAIN CREDIT CARD APPLICATION DISCLOSURE PROVISIONS.—The provisions of section 127(c) shall supersede any provision of the law of any State relating to the disclosure of information in any credit card or charge card

application or solicitation which is subject to the requirements of section 127(c), unless the law of the State explicitly requires the disclosure of such information in a credit card application or solicitation.".

(d) EFFECTIVE DATE.—Any regulation required to be prescribed by the Board under the amendments made by this section shall—

(1) take effect not later than the end of the 90-day period beginning on the date of the enactment of this Act; and

(2) apply only with respect to applications, solicitations, and other material distributed after the end of the 90-day period beginning after the end of the period referred to in paragraph (1).

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100TH CONGRESS
1ST SESSION

S. 647

To establish a limitation on the rates of interest which may be imposed on credit card accounts, and to provide for more detailed disclosures by credit card issuers in application for credit cards.

IN THE SENATE OF THE UNITED STATES

MARCH 3, 1987

Mr. SASSER introduced the following bill; which was read twice and referred to the Committee on Banking, Housing, and Urban Affairs

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A BILL

To establish a limitation on the rates of interest which may be imposed on credit card accounts, and to provide for more detailed disclosures by credit card issuers in application for credit cards.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Credit Card Account Holder Protection Act".

SEC. 2. LIMITATION ON RATES OF INTEREST WHICH MAY BE IMPOSED ON CREDIT CARD ACCOUNTS.

(a) IN GENERAL.—Chapter 2 of the Truth in Lending Act (15 U.S.C. 1631 et seq.) is amended by adding at the end thereof the following new section:

"SEC. 137. MAXIMUM RATES OF INTEREST ON CREDIT CARD ACCOUNTS.

"(a) IN GENERAL.—The rate used to compute the finance charge imposed for any period on any credit extended through the use of a credit card issued by a bank shall not exceed—

"(1) the maximum annual percentage rate for the six-month period during which such period begins, divided by

"(2) the number of such periods which begin during the six-month period in which such period occurs.

"(b) MAXIMUM ANNUAL PERCENTAGE RATE.—

"(1) DEFINITION.—The maximum annual percentage rate applicable under subsection (a) for each calendar quarter is the sum of 6 percentage points and the average Federal Reserve discount rate during the six months preceding the date of the determination.

"(2) DETERMINATION OF RATE.—Before the 5th day of June and December of each year, the Board shall—

"(A) determine the average discount rate during the six preceding months; and

"(B) publish notice of such determination in such manner as the Board shall prescribe.

"(c) BANK DEFINED.—As used in this section and section 127(c), the term 'Bank' has the meaning given by section 19(b)(1) of the Federal Reserve Act.".

(b) CLERICAL AMENDMENT.—The table of sections for chapter 2 of such Act is amended by adding at the end thereof the following new item:

"137. Maximum rates of interest on credit card accounts.".

SEC. 3. CREDIT CARD COST DISCLOSURE REQUIREMENTS.

Section 127 of the Truth in Lending Act (15 U.S.C. 1637) is amended by adding at the end thereof the following new subsection:

"(c) DISCLOSURE IN APPLICATIONS AND SOLICITATIONS FOR CREDIT CARDS.—Any application to open an account for any person under any open end consumer credit plan offered by a bank, and any solicitation by a bank in which such bank offers to open an account for any person under any open end consumer credit plan without requiring such person to complete an application to open such account, shall disclose—

"(1) any annual or other periodic fee;

"(2) any grace period within which an extension of credit may be repaid without a finance charge;

"(3) the amount or method of determining any finance charges to be imposed;

"(4) the amount of any penalties;

"(5) any minimum fees or charges;

"(6) any transaction fees or charges; and

"(7) any other fees or charges.".

SEC. 4. EFFECTIVE DATE.

The amendments made by this Act shall take effect on January 1, 1988.

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Senator DODD. Congressman Schumer will be coming in at some point as well, but let me move to our first panel if I can of Alan Fox, the legislative representative of the Consumer Federation of America; and Elgie Holstein, the associate director of Bankcard Holders of America. Would you both please approach the witness table and we will be delighted to hear your statements this morning or synopsis of your statements this morning. We'll begin with you, Mr. Fox.

STATEMENT OF ALAN FOX, LEGISLATIVE REPRESENTATIVE, CONSUMER FEDERATION OF AMERICA

Mr. Fox. Thank you very much, Mr. Chairman.

My name is Alan Fox and I'm legislative representative of Consumer Federation of America and we appreciate the opportunity to testify here today on these pieces of legislation and, Mr. Chairman, we appreciate your introduction of S. 616 which will greatly improve the disclosures available to consumers looking at and shopping for different credit cards on the market today.

A little over 1 year ago in early 1986, this subcommittee also held a hearing on credit card rates and I want to review what's happened in just over 1 year.

CREDIT CARD RATES REMAIN THE SAME

The prime rate which had been dropping steadily for 2 years as of the time of that hearing continued to drop until very recently, but the prime was 9.5 percent just over 1 year ago. It's now 7.75 or 7.5 percent.

The discount rate in just over 1 year has dropped from 7.5 percent to 5.5 percent.

Another thing that's changed is that banks have managed to change the rates that they pay consumers for consumer savings. According to the Bank Rate Monitor, 1 year ago the average interest paid consumers on 1-year certificates of deposit was 7.91 percent. Today, that rate has fallen to 6.14 percent. In fact, in August 1984, according to Bank Rate Monitor, consumers were paid an average of 11.65 percent on their 1-year certificates of deposit.

One thing hasn't changed in 1 year and that is that credit card rates are nearly as high today as they were 1 year ago. The Federal Reserve Board conducts a quarterly survey of about 120 banks. There are some problems with the weighting of the institutions used in the survey, but even given that, that survey shows credit card rates dropping only from 18.5 percent to 18.1 percent in that year and some months.

Credit card rates today, according to the Federal Reserve, are as high as they were in 1981 when the prime and the discount rates threatened to go off the chart that Senator Shelby showed earlier.

Now in the last year or so there has been a lot of activity around the issue of credit card rates. There have been a lot of hearings and a lot of media attention and there's been a lot of organizing by groups such as mine and Mr. Holstein's.

One thing that's clear from that organizing and clear from our efforts is the interest of the American people in Congress doing something about credit card interest rates.

According to a survey taken by NBC news in May 1986, consumers by a 74-percent to 20 percent margin support Congress passing legislation limiting the amount of interest credit card companies can charge and the question was worded with the phrase, "Even if that means it would be much harder for people like you to get credit."

Consumers are willing to take the chance that lower interest rates will affect the availability of credit to them and to people like them. By an overwhelming margin they support Congress passing legislation limiting credit card interest rates.

Now as I said, in the past year there have been some small changes. Some small issuers have reduced their rates. There's been a great deal of publicity. Some of that publicity has been generated by our organizations in an effort to inform and educate consumers about what their choices are in the market. The credit card industry likes to hold out these few issuers as evidence that the market works. But the reality is that these issuers are relatively small and every time we begin a campaign to tell consumers about these options, those issuers are swamped by applications and are unable to handle the number of applications they receive. The reality is that they are not a threat to the big issuers.

Last month, we saw what happens when the big issuers are threatened by real competition. When American Express announced the introduction of the Optima credit card with a 13.5 percent interest rate, the response of the president of VISA was to write to every bank offering VISA in the United States and urge them to call the president of American Express and "voice your displeasure over his decision to enter one of your most profitable lines of service." Second, he went on, "You may wish to rethink your position in offering American Express products."

Now that's what the industry means when it says "let the marketplace work." Mr. Russell could have sent a very different mailgram to banks around the country. He could have said, "Let's meet this competition head on. Let's tell consumers why we have a better product. Let's fight this out in the free marketplace where the consumer can decide."

Instead, he said, "Let's cut this off before it goes too far." This letter says, "let's use threats to keep competition out and let's do all we can to keep the market from working."

Now it's clear that the letter from Mr. Russell was not an isolated instance. We have received a transcript of a presentation by the senior vice president for marketing of VISA at a conference held in New York City on September 25 of last year. Mr. John Bennett, the senior vice president, says that Disclosure legislation then pending in Congress is unfortunate. A little bit later in his statement it's clear why he believes that. He quotes a survey of users of the Premier VISA card and says that survey shows "only 20 percent know what their correct annual fee or interest rate is. Almost all err on the low side. So the news there is don't tell them about what is really going on."

That's the attitude of the banking industry. It's the real attitude of the credit card profiteers to disclosure legislation and disclosure requirements.

Consumers think they are paying less than they really are. They err on the low side. So don't tell them about what is really going on. And we believe that that's reflected in the statements that you will hear later today from representatives from that industry who believe in only very, very limited and very mild disclosure requirements.

It's important that disclosure legislation that this committee develops be real disclosure, that it be disclosure that's available to consumers when they are making a decision between competing credit cards. I hope the committee will not be confused by arguments that because there's a wide amount of information available under Truth-In-Lending at the time the consumer receives the card that somehow that is a substitute for or replacement for adequate information at the time the consumer makes the decision. It's very, very vital for consumers to have all the information that they need to make an accurate determination of which card is least expensive, is most valuable to them at the time they are making that decision, not at the time that the plastic has arrived.

Mr. Chairman, we have referred some of this material to the Justice Department for investigation because we believe there's a very real possibility that the Russell letter in particular is a violation of Federal antitrust laws.

That's not the real point, though. The point is that Congress can give consumers the relief they need and Congress can give VISA and the other credit card profiteers the answer that's suggested without waiting for investigations and without regard to whether there's been a violation of law or not. The Congress can act now to stop irresponsible exploitation of credit card consumers and we hope the committee will act expeditiously on credit card cap and disclosure legislation.

Thank you.

[The complete statement of Alan Fox follows:]

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STATEMENT ON
"CREDIT CARD DISCLOSURES AND RATE LIMITATION LEGISLATION"

Alan Fox, Legislative Representative
Consumer Federation of America

Before the Subcommittee on Consumer Affairs
Senate Banking Committee
Hon. Christopher Dodd, Chairman
March 26, 1987

My name is Alan Fox. I am Legislative Representative for the Consumer Federation of America (CFA). CFA is the nation's largest consumer advocacy organization, with a membership of over 200 national, state and local consumer, rural, labor, cooperative, senior citizen and other groups that together have over 30 million individual members.

Five years ago, interest rates of all sorts reached record levels. The prime rate topped 20%. The discount rate reached 14%. Three-year Treasury Security constant maturities climbed over 16%.

Today, all of these rates have dropped substantially. Most interest rates are less than half what they were in 1981. But credit card interest rates are today higher than they were in 1981. In August 1981, according to the Federal Reserve, credit card plans offered by a sample of commercial banks averaged 17.8%. In February 1987, those plans charged interest of 18.1%.

This average understates the cost of credit cards to the American consumer. It is a simple average of the rates charged by a small, self-selected pool of card issuers. More complete information, weighted by the number of cards issued by each bank, indicates that the average consumer is charged over 19% for use of a bank credit card.

The cost to consumers

Consumers today owe about $85 billion on bank credit cards, an increase of 150% in just four years. In 1987, consumers will pay about $15 billion in bank card interest and annual fees, or over $1 billion each month. A reduction in credit card interest rates just to the early 1980 level of 17.13% could save consumers over a billion dollars a year in interest charges.

Credit card costs are thus of vital concern to American consumers. Consumers have waited patiently for credit card rates to decline to reflect these reductions in the cost of funds. A survey conducted by NBC News in April, 1986 asked Americans if "Congress should pass legislation limiting the amount of interest credit card companies can charge, even if that means it would be much harder for people like you to get credit?" (emphasis added) Consumers replied "Yes" by a 74-20% margin.

Consumers tell us their patience is wearing thin. The token responses of a few banks are insufficient; it should not be page one news when a bank sets its credit card rates at a reasonable level.

Rates will not come down without Congressional action

Despite the extensive attention excessive credit card

interest rates have received in the past two years, little has changed. Since this Subcommittee last held hearings on credit card rate cap legislation just over a year ago, the prime rate and the discount rate have each fallen by two points. The Federal Reserve's figure for the average credit card rate has dropped less than four-tenths of a point in the same time. A handful of financial institutions, most of them small, have reduced rates to reasonable levels. Only in Connecticut, where the legal interest rate was reduced to 15%, have rates come down across the board. Clearly, state and federal legislative action is needed to force rates down.

It should by now be clear that the market will not be allowed to work by those with a stake in high interest rates. The major banks and credit card companies can stand the limited competition created by the small number of low-rate card issuers. Their share of the market is not seriously threatened by these institutions, and their existence makes the market appear more competitive than it really is.

Two weeks ago, however, we saw how the credit card profiteers react when they are threatened by serious, national rate competition. On Tuesday, March 10, American Express announced that it is introducing the "Optima" card, with a variable rate currently set at 13.5%. On the very next day, Mr. C. T. Russell, the President of Visa, sent a letter to the banks that issue Visa cards. Mr. Russell could have viewed the introduction of Optima as a challenge and urged the banks to meet the challenge through honest, above-board competition. Instead, he asked the banks to protest to the head of American Express and urged them to respond to competition through economic pressure on the new competitor.

Visa and its card-issuing banks know a gold mine when they see one; Russell described banks' credit card operations as "one of your more profitable lines of service." It is quite clear that they will not let competition and the market act to reduce their prices and thus their profits to a reasonable level. Only Congress can ensure consumers fair treatment in the credit card market.

CFA has referred Mr. Russell's letter to the Justice Department for investigation. We believe it to be an indication of an attempt to organize a conspiracy in restraint of trade. Congress, however, has an opportunity to settle this issue. We can think of no better response to Mr. Russell's letter than for Congress to tell Visa and the banks that their irresponsibility requires the enactment of a maximum legal interest rate on credit cards.

The Russell letter is not an isolated incident

Mr. Russell's letter is just one piece of evidence of an increasingly clear pattern of behavior among those who profit from high credit card interest rates. That behavior includes resistance not only to meaningful rate competition, but opposition to meaningful disclosure of credit card costs. In Michigan, for example, each of the ten largest bank card issuers maintains an 18% interest rate, prompting a call for an antitrust investigation from that state's largest consumer organization, the Michigan Citizens Lobby.

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The elements of this behavior were fully described in a speech delivered on September 25, 1986 by Mr. John H. Bennett, Visa's Senior Vice President for Marketing. Mr. Bennett described the wide-spread support for credit card disclosure legislation as "unfortunate." The reason is clear:

> Only 20 percent [of Premier Visa cardholders] know what their correct annual fee or interest rate is. Almost all err on the low side, so the news there is don't tell them about really what is going on.

Mr. Bennett equates competition, particularly on interest rates, with delinquencies and chargeoffs as "threats to your profits." He urges card issuers faced with price competition to "compete without a total price war breaking out," describing as examples responses that "are analogous to the restrictions placed on discount fares by the major airlines -- try to get one of those discount fares."

Contained within this one speech are all the elements of credit card issuers' responses, and all the reasons why the big issuers will not allow the market to bring rates down: Disclosure is to be avoided. Competition is dangerous. Pricing should be made more complicated.

Why rates are too high

Interest rates on credit cards are too high because they do not accurately reflect the costs of funds to banks, because there is insufficient true competition in the market, and because consumers are not provided with information they need to choose between competitors. The result is not only a market in which prices are too high, but one in which consumers are unable to determine the true cost of the service they purchase.

Bankers recognize that the market works to their advantage and that high interest rates can thus be charged to consumers with impunity. They have few incentives to reduce rates, because costs can so easily be passed on to consumers. In fact, some banks are taking advantage of high interest rates to market credit cards to less and less creditworthy customers. All consumers, not just these new customers, pay the costs of that marketing in higher interest rates.

The cost of funds

We do not disagree with the statement, made often by credit card issuers, that credit cards, as unsecured loans, will carry higher rates than secured loans to reflect their greater risk. But the cost of funds is an important element in the cost of extending credit through credit cards, as banks were quick to point out when that cost was increasing. Even after dramatic reductions in the cost of funds, that cost is 40% of the cost of offering a bank card. Credit card rates would, if the market were functioning properly, decline at least a modest amount to reflect dramatic decreases in the costs of funds over the past four years.

The pricing of credit cards was adjusted in many different ways when the cost of funds was increasing. These pricing changes included factors other than interest rates. Annual fees,

in particular, were widely introduced several years ago to compensate for banks' inability to raise interest rates to reflect increases in the cost of funds. As the cost of funds has decreased, annual fees have not come off. In fact, annual fees and miscellaneous charges are continuing to increase.

Banks have had no hesitation about slashing the rates of interest they pay for consumer deposits. In just the past year, according to Bank Rate Monitor, the national average paid consumers for their money market accounts has slipped from 6.65% to 5.42%. The rates banks will pay for one-year certificates of deposit have dropped from 11.65% in August 1984, to 7.91% a year ago, to 6.14% today.

Imperfect competition

The fact that rates have not come down to match reductions in costs is as good an indication as any that competition and the market are not functioning properly. We should not confuse the existence of a large number of providers of a service with the existence of competition. A large number of providers constitute a necessary, but not a sufficient, condition for a competitive market.

Competition is imperfect in all markets for consumer credit because of the disparity in information and market power between the offeror of credit and the consumer. The National Commission on Consumer Finance in 1972 stated that "the statistical evidence considered here indicates that competition cannot be relied upon at this point in time to establish rates at reasonably competitive levels in many states."

In testimony before a Senate subcommittee in 1983, Manuel Johnson, then the Assistant Secretary of the Treasury for Economic Policy stated that:

> Consumer loan rates are generally considered to be administered rates. That is, they are posted by lenders rather than set by the market interaction of supply and demand conditions. . .(S. Hrg. 98-73, March 17, 1983, p. 19)

A month later, at a full Senate Banking Committee hearing, Senator Proxmire asked Federal Reserve Board Governor J. Charles Partee to comment on that statement. Governor Partee replied:

> There is a degree of administration, no doubt, in the consumer lending area. As a Virginia resident, I have recently been receiving notices from the department stores that they will be raising their rates to 21.6 percent beginning in April. And there's no economic or marketplace justification whatsoever for that. It simply reflects an increase in the usury ceiling permitted in the State of Virginia. (emphasis added) (S. Hrg. 98-111, April 12, 1983, p. 48)

Credit cards, as well as other forms of open-end credit, present some conditions which make competition even more difficult than for other forms of credit. Annual fees lock consumers in to a particular card for an entire year. The

Senator DODD. Thank you.
Mr. Holstein.

STATEMENT OF ELGIE HOLSTEIN, DIRECTOR, BANKCARD HOLDERS OF AMERICA

Mr. HOLSTEIN. Thank you, Mr. Chairman.

My name is Elgie Holstein and I am the director of Bankcard Holders of America. We are a nonprofit consumer education group based here in Washington dedicated to informing consumers about their rights and their responsibilities as credit card holders.

We have been working over the last year not only with Members of Congress but also with State legislators throughout the country who have been very interested in this issue as well, including legislators in many of your home States.

BANKS MOST PROFITABLE AREA

I won't review the figures that Senator Shelby has already reviewed and Alan Fox, but I will point out that in addition to the interest rates, annual fees, late fees, over the limit fees, and transaction charges, are now prevalent on credit cards—and in some cases, shortened or eliminated grace periods—have been added in the 1980's and have further added to the profitability of credit cards. So that credit cards, it is easy to see, have become the most profitable area of banking today, certainly, in percentage terms.

I think then that it is appropriate to say that this is the time for Congress to consider whether or not it should assert its traditional role as guardian of fair financial paly.

Last year, 7 States did take action through legislation to help provide greater consumer protection relating to credit cards, both disclosure and interest rate cap legislation were included, and Connecticut as you know, Mr. Chairman, was one of those States that took one of the more aggressive actions.

Interestingly enough, a hot rate war broke out in Connecticut before the bill was even signed by Governor O'Neal. In fact, none of the gloom and doom predictions made by the banks when that legislation was under consideration have yet come true. No bank has left the State of Connecticut or moved card operations out. Credit has not dried up in the State and banks certainly as far as we can tell are not losing any money.

Indeed, the 15-percent ceiling has not even become a floor. The active competition that's taking place has prompted banks to offer rates not just on a promotional basis but on an ongoing basis lower than the 15-percent ceiling.

Now granted, in some States this battle is being fought a little bit rougher. State Treasurer Jerry Cosentino, the Treasurer of Illinois, acting on a campaign promise made over 1 year ago, has withdrawn over $2.2 billion in annual State business from the First National Bank of Chicago and from the American National Bank specifically because of their refusal to lower credit card interest rates.

Not only has Treasurer Cosentino succeeded in obtaining a greater return on the redeposited funds, but at the same time he has persuaded a number of banks to lower their credit card interest rates far below what First Chicago continues to charge. Cosentino

has called these interest rates unacceptable to the public and stated recently;

> As long as big banks continue to offer the equivalent of juice loans to the American people, as long as the Federal Government turns a deaf ear to the practices of the credit card industry, State treasurers with the power to move State funds must use our good offices to provide relief for the American people.

Nevertheless, most State officials are reluctant to exercise their traditional role in setting limits on credit card interest rates. This is specifically because of their inability to control the interest rates charged by card issuers located outside their borders. As Treasurer Cosentino points out in his testimony, "It's routine, but it makes no sense to have a credit card issued to an Illinois resident by a New York bank governed by Idaho law."

Now I've seen many bank representatives appear before State legislatures in every region of the country and their arguments are always the same. They argue that rate cap legislation would put banks within the State at a competitive disadvantage vis-a-vis banks located outside the State.

I think it's also fair to say that in a number of instances the banks have gone so far as to threaten to move card operations and the jobs associated with those operations to other States to take advantage of this State-against-State kind of economic threat.

Congressional action would put an end to this so-called "race to the bottom," to this State-against-State kind of pressure that is undermining the ability of your States' leaders to protect their own consumers as they have done for decades with usury laws.

FLOATING INTEREST RATE CAP

I think that the legislation to impose a floating interest rate cap nationally provides a reasonable compromise. It is not a return to the bad old days of a flat fixed ceiling. In fact, it would do precisely what has attracted the attention of all the members of this committee and that is correct the failure of credit card interest rates to reflect the general trends of other interest rates in the economy. Instead of locking them in, a floating interest rate cap would permit the interest rate ceiling to float freely with other rates in the economy, which is after all what we are after.

At a minimum, however—and I want to stress this point as an alternative for your consideration—I think that it is important for Congress, even if it chooses not to take action to impose a national interest rate ceiling, to restore to the States their traditional ability to protect your own consumers and I think the way to do that would be simply to reverse the *Marquette* decision legislatively and simply give States the authority to apply their usury laws to credit card issuers even if that issuer is located outside the State. Any credit card offerer who came into the State would not only be subject to reasonable disclosure requirements but also would be subject to the State's interest rate protection. That way, the issue could be fought out where it has always been fought out, at the State legislative level.

The banks have argued that less credit would be available if you were to impose a national interest rate ceiling. I think that ignores a very fundamental element of the credit card business. Today, the

credit card business is a highly saturated business, very mature, 186 million bank cards in circulation, over 700 million total credit cards in circulation. Credit card marketing today is primarily the issuance of credit cards to people who already have one or two or more bank cards in their possession. Not a single one of these people would be expected to lose their credit cards if the interest rate on those cards were dropped from 20 or 19 percent down to 13 to 15 percent. They in fact would become more creditworthy, not less.

What about first-time card applicants, because we do have to be concerned about those as well? I think here much of the fault lies with the banks themselves, and not even all the banks, simply those larger interstate institutions that have dominated the credit card market and that mass market cards across State lines, often with very little disclosure and very high interest rates. These are the folks who are dominating the credit card market and I think that if we were simply to look at their loss rates what you would find is that the banks that are mass marketing cards indiscriminately are experiencing the highest loss rates.

On the disclosure issue—and I'll just mention very briefly our views on that—I think full, prominent disclosure is long overdue and I think you may want to consider an addition that several States are adding this year which is a requirement that 30 days prior to the expiration or renewal date of the card that the banks be required to let the consumer know that the annual fee will be reapplied 1 month hence.

Thank you, Mr. Chairman. I appreciate the opportunity to appear.

[The complete prepared statement of Elgie Holstein follows:]

open-end nature of the agreement makes a calculation of the true costs of credit difficult; fees cannot be rolled into the interest charge for a single, accurate annual percentage rate figure. Perhaps most important, the cost of open-end credit cannot be reduced to dollars and cents before an agreement is entered into as the costs of other credit contracts can. When all is said and done, the purchasers of a new home or a new car or a refrigerator compare figures for monthly payments more than they do APRs. But credit card plans by their nature cannot provide comparable information. In addition, most consumers are simply unaware of what market does exist. There is a general assumption, for example, that all Visa cards are identical.

These are not arguments to restrict the use or availability of credit cards, but they do point to reasons why the market functions differently, and less competitively, than for other forms of consumer credit. Public policy should take these conditions into account, and not simply rely on a market which does not exist.

All consumers pay for risky credit extensions

Lack of meaningful competition has other implications for the costs of credit as well. We believe that banks have not responded aggressively to bank card fraud and have accepted accounts with higher probabilities of default because they can pass these costs on to consumers without risking loss of business. Restrictions on interest rates and other bank card costs may provide the incentive banks need to reduce both fraud and bad debts.

The connection between high interest rates and bank tolerance of fraud is well-documented. The December 2, 1985 Wall Street Journal describes several bank card programs awash in losses because they have pushed credit cards to consumers who were not creditworthy. But even the creditworthy consumers of those cards are forced to bear the increased fees and interest charges used to finance those expansion campaigns. As the article reported:

> Credit cards' steep fees and rates have kept that business profitable for most banks, in spite of surging charge-offs. And many big institutions are willing to absorb charge-card losses because the cards are seen as a way to build a nationwide customer base in anticipation of interstate banking a few years hence.

The Lexecon report prepared in 1986 for the American Bankers Association, MasterCard, and Visa, entitled Interest Rate Controls on Credit Cards -- An Economic Analysis even goes so far as to argue that increased charge-offs are a healthy sign. Table 5 of the report (page 53) shows Visa charge-off rates in states with no interest rate controls to be over 50% higher than charge-offs in states with moderate or strict rate controls. "This indicates," the report says, "that unregulated bank card programs are much more likely to take business risks in order to supply cards to a greater number of consumers." It would be more accurate to say that creditworthy consumers are bearing the costs of those risks by paying banks tens of millions of dollars in

excessive interest charges.

Better disclosure needed

Banks can pass these costs on to consumers because most consumers simply do not know what they are paying for the use of their credit cards. Consumers do not receive clear information about credit card costs when they are asked to apply for credit cards. Current law provides for most disclosures only after the consumer has applied for and received a card.

Credit card solicitations sometimes include the amount of the annual fee and the interest rate, but these disclosures are rarely clear or conspicuous. They commonly appear in fine print on the back of the application, an application which is smothered in several pages of glossy four-color hype. Important terms such as late fees and other charges and the method of calculation of balances on which interest may be paid are not disclosed.

As a result, applying for credit cards is a little like playing the lottery. Consumers do not find out what they need to make an informed choice until they have applied for and received the plastic card itself. Congress should amend the Truth in Lending Act disclosure requirements with respect to open-end credit to require that all the conditions of credit cards be spelled out to a consumer in all promotional material which includes an application for credit.

Balance calculation methods

Even when consumers have good information about the basic pricing factors -- interest rate, periodic fee, grace period -- they still cannot compare the dollars and cents costs of different credit cards. A variety of conditions, some due to the nature of open-end credit, some due to insufficient disclosures, contribute to consumers' inability to determine the true costs of credit card use. One important factor is the impact of different balance calculation methods.

We all tend to think of credit costs purely in terms of interest rates. The assumption is that since 18% is less than 21%, a card with an 18% interest rate will cost less than one with a 21% rate.

A report prepared for the General Assembly of Virginia by the Colgate Darden Graduate School of Business Administration of the University of Virginia, entitled Credit Card Billing Practices in Virginia, illustrates the large effect balance calculation methods have on costs to consumers.

The report demonstrates the costs consumers might bear under four balance methods permitted by Virginia law. On accounts with identical patterns of activity -- a $400 previous balance, $300 payment, and $50 purchase at 18% during one month -- the finance charge ranged from $1.50 to $6 -- a factor of four.

The effect of these different balance calculation methods is far greater than the effect of even relatively large changes in the interest rate. An account using the most expensive method, the previous balance method, would have to have an interest reduced all the way down to 4.5% to result in finance charges as low as the least expensive alternative, the adjusted balance method, and the rate would have to drop to 11.25% to match the costs of even the second most expensive alternative. Conversely,

an account with an adjusted balance method could bear an interest rate of up to 72% before it would match the costs of the 18% previous balance method account.

Credit card loss insurance

Consumers are well protected from liability for lost or stolen credit cards. Once they notify the card issuer that a card is missing, they are not liable for any charges. Even before notification, liability is limited to $50.

The sale of insurance against this $50 liability thus preys on consumers' lack of knowledge of their legal rights. It is hard to imagine a more lucrative form of insurance than one designed to meet such a modest liability.

We have little information on the extent to which credit card loss insurance is marketed and at what cost. In some cases, this insurance may be marketed in conjunction with notification and cancellation services that may be of some value to a consumer. We hope the subcommittee will pursue this matter. At a minimum, all promotional material for such insurance should be required to state very clearly the limited nature of consumers' liability and the limited nature of the insurance.

Recommendations

1. Enact a floating cap on credit card interest rates. We believe that Congress should establish federal limits on credit card rates. Credit cards, more than any other form of consumer credit, are marketed across state lines by banks which take advantage of favorable conditions in some states to create an interstate market.

In the past, we have opposed Federal preemption of state interest rate ceilings. We believe that the states have acted responsibly to balance the needs of creditors and consumers in the market for credit. Credit cards differ from other forms of consumer credit in that a national market has been established which allows offerors of bank cards to market those cards in a manner which restricts the States' ability to regulate the cost of credit within their borders.

We reject the argument that a credit card rate cap will unduly restrict consumer credit. A cap that rises and falls flexibly with market conditions provides consumers and credit card offerers with balanced protections and should not unduly affect credit availability.

Even a fixed-rate cap, under proper conditions, will not restrict access to credit. The effect of Connecticut's reduction of its interest rate cap from 18% to 15% has been to expand available credit, and the effect of 19.8% and 21% rates in other states is clearly the offering of credit to uncreditworthy consumers including children, prison inmates, and household pets. We do not believe that consumers are well served by practices that encourage availability of credit to that degree. So long as a rate cap allows an opportunity to make a reasonable profit, adequate credit will be available.

If a national interest rate ceiling is established, Congress should be careful to ensure that other charges or conditions cannot be changed to thwart the intent of such a ceiling. There is probably little danger that annual fees can be increased

substantially; consumers are very sensitive to annual fees because they can be so easily compared. But consumers would not be served if interest rates were reduced but grace periods for payment were removed. Restricting interest rates without restricting banks' ability to shift costs in this manner would not be seen as positive legislation by consumers.

2. Return the power to regulate bank card rates to the states. The most expensive credit cards on the market today are those marketed nationally by banks working from a single state with unusually high or no interest rate ceilings. If Congress chooses not to restrict credit card rates nationally, it should at least allow the states a meaningful opportunity to do so. Congress could reduce credit card costs substantially if it simply required banks to abide by interest rate ceilings in the state of residence of the consumer. Offerors of gasoline and other retail credit cards must abide by such limits currently.

3. Make card issuers tell consumers what their cards will cost. Regardless of whether Congress acts to cap credit card rates, improved disclosure is needed to allow consumers to compare competing cards. The Truth in Lending Act should require each solicitation that includes an application for a credit card to include a standardized table showing fees, interest rates, and conditions under which fees or interest may be charged. The table should include all ways in which consumers might have to pay for the use of a credit card, and fees not disclosed in the table should be prohibited.

We believe that S. 616 provides for complete disclosures in a useful form. We hope that the strong support in the 99th Congress for credit card disclosure will continue this year in the form of support for S. 616.

4. Standardize balance calculation methods. These disclosures will not be useful unless balance calculation methods are standardized. All the disclosures in the world will not allow a consume to compare costs when balance calculation methods are uncontrolled. The complexity of these different methods, and the many permutations designed by lenders, do not lead to further disclosure requirements as a solution. Credit card offerors should be required to use a carefully defined average daily balance method to calculate the balances against which finance charges may be imposed. Standardization of balance calculations, coupled with full disclosure of all fees and charges, will give consumers a chance to make the market work.

EXHIBIT A

(Sent by Western Union Mail-A-Gram, San Francisco, CA)

March 11, 1987

As you know, American Express announced their "Optima" non-bank credit card program yesterday. This card is positioned to be directly competitive with your Visa and MasterCard portfolios. Optima will carry a 13.5 percent interest rate and a $15.00 annual fee; however, it requires the cardholder to purchase another American Express Card (green, gold, and platinum) to qualify. The essence of this move is an attempt by American Express to further its presence in the retail banking market by acquiring additional relationship with your better customers.

What type of response might banks such as yours consider? First of all, you might call Mr. Robinson (212-640-3504) and voice your displeasure over his decision to enter one of your most profitable lines of service. Secondly, you may wish to rethink your position in offering American Express products.

I am alerting you of this development because, in my view, the Optima credit card service will have a far greater effect, in the long run, upon your banks profits than will the much publicized Discover Card which was recently launched by Sears Roebuck and Company. American Express is experienced in dealing with merchants, they have a proven product in the marketplace and they are down selling in a market rather than trying to overcome a "Sears" image.

Please take what ever steps you think best serves your banks interest.

Cordially,

C.T. Russell
President
Visa U.S. Inc.

EXHIBIT B

Interest Rates Since 1981

	Credit Cards	Prime Rate	Discount Rate
Feb-81	17.58	19.50	13.00
May-81	17.71	18.43	13.29
Aug-81	17.78	20.50	14.00
Nov-81	18.04	17.29	13.00
Feb-82	18.14	16.50	12.00
May-82	18.41	16.50	12.00
Aug-82	18.73	15.00	11.00
Nov-82	18.75	12.00	9.50
Feb-83	18.82	11.00	8.50
May-83	18.79	10.50	8.50
Aug-83	18.75	10.50	8.50
Nov-83	18.75	11.00	8.50
Feb-84	18.73	11.00	8.50
May-84	18.71	12.00	9.00
Aug-84	18.81	13.00	9.00
Nov-84	18.82	12.00	9.00
Feb-85	18.85	10.50	8.00
May-85	18.74	10.50	8.00
Aug-85	18.62	9.50	7.50
Nov-85	18.57	9.50	7.50
Feb-86	18.48	9.50	7.50
May-86	18.32	8.50	6.50
Aug-86	18.15	8.00	6.00
Nov-86	18.09	7.50	5.50
Feb-87	18.10	7.50	5.50

Source: Federal Reserve Board Statistical Releases

TESTIMONY OF ELGIE HOLSTEIN
DIRECTOR
BANKCARD HOLDERS OF AMERICA
BEFORE THE SUBCOMMITTEE ON CONSUMER AFFAIRS
OF THE SENATE COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
MARCH 26, 1987

I am pleased to present testimony today on behalf of Bankcard Holders of America (BHA). BHA is a national, non-profit consumer organization dedicated to informing its members and the public about their rights and responsibilities as credit card users. BHA has been working actively to provide information to state and federal officials reviewing credit card issues, and we appreciate the invitation to appear before you today.

Since this committee last met to consider credit card consumer protection legislation, the case for action has grown even stronger. In 1986, the Federal Reserve's discount rate -- a good indicator of the banks' cost of funds and a major determinant of other rates -- dropped four times, two full percentage points, and now stands at 5.5%, which is less than half of what it was in 1981.

Following the discount rate, the prime rate dropped in 1986 to 7.5%.

The average thirty-year mortgage has fallen below 10%.

What happened to credit card interest rates in 1986? On average, they fell less than one-half of one percent and today, at 18.4%, are still higher than they were in 1981.

Adding to the profitability of credit cards over the last several years have been the drop in the inflation rate from double digits to less than 2% today, and the introduction of annual fees, late fees, over-the-limit fees, and transaction charges. All of these have been defended by the credit card industry as necessary to recover the administrative costs of operating a card program. Adding in merchant fees and high interest rates, both of which are also defended as necessary to defray administrative costs, it is easy to see why credit cards have become the most profitable area of banking today. And with the banks paying six to seven percent for the money they lend out to cardholders at eighteen to twenty percent, it is easy to see why the banks continue to resist free-market pricing of their cards.

To deal with the utter failure by banks to compete on credit card financial terms, we believe it is time for Congress to assert its role as the guardian of fair financial play. In recent years, the banking industry has won many new privileges from the federal government. As you know, it is now seeking even broader deregulation. Yet the many

ways in which government policies will continue to support the liquidity of the banking system underscore the need for a cooperative relationship. Simply stated, public confidence in the stability of the banking system in this country relies in large measure on fair treatment from the banks. Credit card interest rates are one area where the banks have not held up their end of the bargain, and so Congress must act.

Last year, seven states enacted legislation to help provide greater protection to cardholders from unfair and costly practices. One of those states, Connecticut, imposed a fixed 15% ceiling on credit card interest rates. Before the Governor signed the bill, a rate war broke out among the card issuers in that state. Equally important, none of the gloom-and-doom predictions about the results of such action has come to pass. Credit has not dried up in Connecticut; card operations have not been moved out-of-state; banks are certainly not losing money.

In some states, the fight over higher rates is a bit rougher. Over the last several weeks, Jerry Cosentino, Treasurer of the State of Illinois, has withdrawn over $2.2 billion in annual state business from the First National Bank of Chicago and the American National Bank because of their refusal to lower credit card interest rates. Not only has Treasurer Cosentino succeeded in obtaining a greater return on the redeposited funds, but at the same time he has persuaded fifteen banks to offer credit cards at rates six percentage points below what First Chicago continues to charge.

While calling on Congress to act on behalf of consumers nationally, the Treasurer has made clear that states do have some weapons at their disposal. As he stated recently, "As long as big banks continue to offer the equivalent of "juice loans" to the American people, as long as the Federal Government turns a deaf ear to the practices of the credit card industry, state treasurers with the power to move state funds must use our good offices to provide relief for the American people."

Nevertheless, most state officials are reluctant to exercise their traditional role in setting limits on credit card interest rates because of their inability to control rates charged by banks issuing cards to their citizens from outside their borders. As Treasurer Cosentino points out in his testimony, "it is routine, but it makes no sense, for example, to have a credit card issued by a New York bank governed by Idaho law issued to an Illinois resident."

Before the legislative committees the banks argue that state "cap" legislation would put them at a competitive disadvantage against their out-of-state competitors. In some cases, they also threaten to move jobs to other states if a tough state rate ceiling is enacted. Congressional action can put an end to this state-against-state pressure that is undermining the ability of state leaders to protect their consumers.

Rather than imposing a flat ceiling on credit card interest rates, which could prevent the banks from recovering their costs should interest rates throughout the economy rise, we believe that a fair compromise between the interests of consumers and bankers would be a floating cap on rates. Tying the cap to an index of other rates, such as Treasury bills or the Federal Reserve's discount rate, would permit the banks to raise rates when their costs go up. But when interest rates in the economy go down -- as they have for the last six years-- consumers would pay lower interest charges on their cards.

At a minimum, Congress should act to allow states to exercise their traditional role as regulators of the terms of consumer credit for their own residents. By specifically permitting states to regulate the terms of all cards issued to their residents, regardless of the location of the issuer, Congress would restore to states the comprehensive consumer protection authority they now lack because of the interstate nature of the credit card business. Thus, credit card cost regulation could be debated in the states on the merits, not on the basis of the distortions caused by partial jurisdiction.

Some banking industry representatives have argued that lower rates would cause them to restrict the ready availability of credit. To see beyond this particular smokescreen argument, it is necessary to examine the credit card industry more closely. Today that industry is a mature, permanent part of our economic landscape. Seventy-five million Americans are carrying one hundred eighty-six million bankcards. The bulk of credit card marketing is directed at Americans who already have credit cards.

If Congress were to enact a reasonable ceiling on credit card interest rates, not one single current cardholder would be expected to have his card confiscated. If that person is creditworthy at 19% interest, he becomes more creditworthy -- not less -- at a lower rate, since monthly debt obligations obviously will be less.

What about first-time card applicants? Just as in the cases of automobile loans and personal loans, it is true that lower credit card profit margins may force greater scrutiny by the banks of credit card applications, especially those they send out through mass mailings on a so-called "pre-approved" basis. First-time applicants with a reasonably stable credit background -- a steady job, an absence of heavy debt, etc. -- will continue to qualify for cards. Reducing the availability of cards to unemployed teenagers, inmates, children, and household pets seems to be a small price to pay for lower credit card rates for everyone else.

Interest rate ceilings, however, are not enough to protect consumers from usurious credit card charges. This is because most credit card advertising, including direct mail solicitations, camouflage the high costs of the cards. The rates and fees are often printed in microscopic lettering, and, in some cases, consumers do not learn what

those charges will be until after they have received their cards. Even then, many are unable to understand the complex methods used to calculate monthly bills.

This ongoing consumer confusion makes it possible for the banks to restrict their "competition" to travel and entertainment frills instead of offering fair financial terms. Thus, credit card advertising emphasizes prestige appeals and enhancements such as health club memberships, travel services, and book-of-the-month clubs. In fact, many card advertisements make no reference at all to rates and fees, denying prospective cardholders the information they need to "shop around" for the best financial terms.

It is clear that card issuers are complying with the letter, but not the spirit of the Truth in Lending Act. A requirement for full and prominent disclosure of all financial terms in credit card advertising would provide the incentive banks now lack to compete actively on the basis of card charges. One element of the disclosure issue not addressed in the several bills before you does not deal with solicitations aimed at prospective cardholders. Many cardholders lose track of exactly when they first applied for and received their cards. Suddenly, and without warning, an annual fee appears among the other charges listed on the monthly statement. The consumer is forced to either pay the fee or the entire balance is due. Once the annual fee is paid, the consumer is dissuaded from switching from or dropping the card because most banks do not provide a refund of the fee. We recommend a simple additional requirement that at least thirty days prior to the renewal date of the card, the cardhoder be provided with notice of any upcoming annual charge.

I believe there has been a tendency on the part of consumers and their elected officials to look upon their credit cards as different somehow from the "real money" they carry in their wallets. Perhaps if we were experiencing high mortgage interest or auto loan charges instead of high credit card rates, this debate would not have lasted so long. The fact is that with outstanding credit card debt at $152 billion, it is time for all of us to take our "plastic money" seriously. That means consumers need to educate themselves about their use of credit, issuers need to price credit competitively, and elected officials must ensure a fair balancing of the interests of both.

Accordingly, I would like to express my appreciation to the Chairman and Members of this committee for their continued attention to the problems of credit card pricing and advertising, and for this opportunity to appear before you.

Senator DODD. Thank you very much, Mr. Holstein.

Before going into questions, Senator Sasser has joined us. Senator, any opening statement you would like to make?

OPENING STATEMENT OF SENATOR SASSER

Senator SASSER. Well, thank you very much, Mr. Chairman.

First, I want to commend you for convening these very important hearings this morning and thank you for the opportunity to appear here.

I think the legislation that we're considering today addresses one of the most troubling problems facing consumers and facing our economy—that is artificially high credit card interest rates.

Now we've heard testimony this morning that 5 years ago the prime interest rates stood at about 16.5 percent, and credit card interest rates at that time were, slightly over 18 percent. Well, today, we have the situation where the prime rate is down at 8 percent, and inflation is at its lowest level in 25 years. Last year I think the inflation rate was something like 1.5 percent, yet credit card interest rates haven't dropped a bit.

Now this has been, Mr. Chairman, in absolute defiance of the general economic climate. We've witnessed what I think is a monolithic immobility of credit card interest rates.

Despite claims to the contrary, it's clear to me that the cost of money is a very, very significant component of credit card interest rates. I think the price of credit cards ought to come down when the price of money comes down.

Now why have these credit card rates remained at unrealistically high levels while other interest rate components have responded to market forces?

I think the answer is self-evident. There simply is a lack of competition in the credit card business. A relatively small number of very large card issuers keep these rates artificially high. In short, Mr. Chairman, we are seeing the guiding hand of the marketplace quietly and I think very effectively shackled.

Now I have introduced legislation, S. 647, which would place a floating cap on credit card interest rates and provide for disclosure. Today, you simply have a very, very difficult time in determining what sort of interest rates you're paying because you have to wade through all sorts of fine print and there are different ways of calculating the interest rate. I think we need to have a full and standard disclosure.

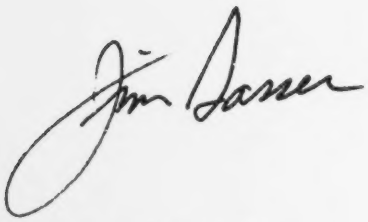
Now the argument is made that an interest rate ceiling would result in less credit being available for consumers. Well, we've heard already that there are holes in that argument because an NBC news poll indicates that 74 percent of the public would prefer to have Congress limit credit card interest rates even if it means that credit is harder to get.

So, in sum, Mr. Chairman, we are not tampering with market forces here. We actually are seeking to free them. We are seeking to create a more efficient market. I think a floating cap would be precisely the way to do that.

Mr. Chairman, I have additional comments which I would like to have included in the record at this point and I thank you for deferring to me.

Senator DODD. Without objection, so ordered.

[The complete prepared statement of Senator Sasser follows:]



STATEMENT OF SENATOR JIM SASSER -- CREDIT CARD INTEREST RATE HEARING -- U.S. SENATE BANKING COMMITTEE -- APRIL 21, 1987

SENATOR SASSER:

MR. CHAIRMAN, THANK YOU FOR THE OPPORTUNITY TO PARTICIPATE IN THIS IMPORTANT HEARING. THE LEGISLATION WE ARE CONSIDERING TODAY ADDRESSES ONE OF THE MOST TROUBLING PROBLEMS FACING CONSUMERS AND OUR ECONOMY -- ARTIFICIALLY HIGH CREDIT CARD INTEREST RATES.

FIVE YEARS AGO CREDIT CARD INTEREST RATES AVERAGED 18.1%, WHILE THE PRIME RATE STOOD AT 16.5%. TODAY, THE PRIME RATE IS DOWN TO AROUND 8%. INFLATION IS WAY DOWN. YET CREDIT CARD RATES HAVEN'T DROPPED AT ALL. FOR SEVERAL YEARS NOW -- IN ABSOLUTE DEFIANCE OF THE GENERAL ECONOMIC CLIMATE -- WE HAVE WITNESSED MONOLITHIC IMMOBILITY OF CREDIT CARD INTEREST RATES.

MR. CHAIRMAN, DESPITE CLAIMS TO THE CONTRARY, IT'S CLEAR THE THE COST OF MONEY IS A VERY SIGNIFICANT COMPONENT OF CREDIT CARD INTEREST RATES. SHOULDN'T THE PRICE OF CREDIT FOR THE AVERAGE CONSUMER DROP -- AT LEAST TO SOME DEGREE -- ALONG WITH THE DECLINE IN WHAT BANKS PAY FOR MONEY?

WHY HAVE CREDIT CARD RATES REMAINED UNREALISTCALLY HIGH WHILE OTHER INTEREST RATES HAVE RESPONDED TO MARKET FORCES? THE ANSWER IS EVIDENT: THERE IS A LACK OF COMPETITION IN THE CREDIT CARD BUSINESS. A RELATIVELY SMALL NUMBER OF VERY LARGE CARD ISSUERS KEEP RATES ARTIFICIALLY HIGH.

IN SHORT, THE GUIDING HAND OF THE MARKETPLACE HAS BEEN QUIETLY SHACKELED.

NOT ONLY ARE THE RATES KEPT HIGH, BUT MANY CONSUMERS ARE KEPT IN THE DARK ABOUT HOW MUCH THEY'RE PAYING FOR CREDIT. FRANKLY, THERE'S NOTHING RESEMBLING AN "EDUCATED CONSUMER" OF CREDIT CARDS. WHEN CONSUMERS APPLY FOR CREDIT CARDS, THEY MUST PLOW THROUGH PAGES OF LEGALIZE AND FINE-PRINT. WHEN THEY'RE DONE, THEY RARELY KNOW THE ANNUAL FEE THEY'RE PAYING OR THE OTHER TERMS THEY'VE AGREED TO.

IS DISCLOSURE ENOUGH TO CORRECT THIS SITUATION? I AM AFRAID NOT. DISCLOSURE WILL DO NOTHING FOR PERSONS ALREADY LOCKED IN TO BOTH HIGH ANNUAL FEES AND EXHORBITANT INTEREST RATES. NOR WILL IT DO ANYTHING ABOUT INTEREST RATES THAT CAN BE CHANGED AT WILL. IT WILL DO NOTHING ABOUT THE CONSUMER DEBT WHICH IS BURGEONING IN OUR ECONOMY. DISCLOSURE IS ONLY A BEGINNING.

MY BILL, S. 647, WOULD PLACE A FLOATING CAP ON CREDIT CARD INTEREST RATES AND PROVIDE FOR DISCLOSURE. I EMPHASIZE THE WORD "FLOATING"; UNDER MY BILL THE MARKET WOULD STILL DETERMINE THE COST OF FUNDS BEING LENT. BUT THE CAP WOULD FORCE THE CREDIT CARD INDUSTRY TO CORRECT ITS INEFFICIENCIES AND BECOME MORE RESPONSIVE TO THE MARKET.

I KNOW THERE ARE PROBLEMS WITH A CAP. BUT NOT THE PROBLEMS YOU HEAR ABOUT FROM THE INDUSTRY. I'M AFRAID THAT THERE MAY BE TOO MANY WAYS TO GET AROUND A CAP. IN RESPONSE, CARD ISSUERS COULD RAISE ANNUAL FEES, CHANGE BALANCE CALCULATION METHODS, GET RID OF GRACE PERIODS AND CHARGE TRANSACTION FEES. THAT'S WHY I'M

PROPOSING RIGOROUS DISCLOSURE OF SUCH FEES AND CALCULATION METHODS.

INDEED, THE ARGUMENTS WE HEAR AGAINST A CAP RAISE MANY QUESTIONS. WE'VE ALL HEARD OF HIGH ADMINISTRATIVE COSTS AS A REASON WHY A CAP IS WRONG AND WHY RATES CAN'T COME DOWN. YET, IT MAKES NO SENSE TO ME THAT BANKS' ADMINISTRATIVE COSTS CAN BE RISING SO DRAMATICALLY AT TIME WHEN INFLATION HAS DECLINED.

THEY SAY THAT BANK CARDS JUST AREN'T PROFITABLE. WELL THEN, WHY DID THE PRESIDENT OF VISA WARN BANKS AGAINST THE ENTRY INTO THE MARKET OF A LOW INTEREST AMERICAN EXPRESS CARD? THIS GENTLEMAN SAID AMERICAN EXPRESS WAS ENTERING AND I QUOTE, ONE OF THE BANKS' "MOST PROFITABLE LINES OF SERVICE." INSTEAD OF SUGGESTING THAT BANKS LOWER THEIR RATES, HE URGED THEM NOT TO SELL AMERICAN EXPRESS TRAVELLERS CHECKS.

MR. CHAIRMAN, I FIND THIS TO BE AN INCREDIBLE STATEMENT IN LIGHT OF THE HOWLS OF PROTEST I HAVE HEARD FROM BANKERS AND OTHERS WHO CLAIM THAT THEY ARE PROVIDING CREDIT CARDS AT A LOSS AND OUT OF THE GOODNESS OF THEIR HEARTS. CLEARLY, BANK CARDS ARE VERY PROFITABLE.

ANOTHER EXAMPLE OF THIS SUBTERFUGE IS THE ARGUMENT THAT AN INTEREST RATE CEILING WILL RESULT IN LESS CREDIT BEING AVAILABLE FOR CONSUMERS. BUT, A RECENT NBC NEWS POLL INDICATES THAT 74% OF THE PUBLIC WOULD PREFER TO HAVE CONGRESS LIMIT CREDIT CARD INTEREST RATES, EVEN IF IT MEANS CREDIT WILL BE HARDER TO GET.

IN SUM, MR. CHAIRMAN, I SUBMIT THAT WE ARE NOT TAMPERING WITH MARKET FORCES. WE ARE SEEKING TO FREE THEM AND CREATE AN EFFICIENT MARKET. I THINK A FLOATING CAP, IN SOME FORM, IS NECESSARY. INDEED, I WOULD EVEN CONSIDER PHASING ONE IN OVER A PERIOD OF TIME. THIS WOULD ALLOW THE INDUSTRY TO ADJUST ITS ADMINISTRATIVE EXPENSES AND DEVELOP MORE EFFICIENT OPERATIONS.

MOST IMPORTANTLY, SHOULD CONGRESS CHOOSE NOT TO ENACT A CAP, WE SHOULD AT LEAST PERMIT THE STATES TO ENACT EFFECTIVE AND MEANINGFUL LEGISLATION TO PROTECT CREDIT CARD HOLDERS.

RIGHT NOW STATES CAN NOT ENACT SUCH LEGISLATION. AS A RESULT OF THE MARQUETTE DECISION OF THE U.S. SUPREME COURT, BANKS ARE PERMITTED TO "EXPORT" OR SEND THEIR CREDIT CARD INTEREST RATES ACROSS STATE LINES. CONSEQUENTLY, WE HAVE A SITUATION WHERE THE BIG BANKS SHOP AROUND FOR A STATE PERMITTING AN EXORBITANT RATE AND THEN ISSUE THEIR CREDIT CARD FROM THERE. THIS MEANS THAT AN INDIVIDUAL STATE CAN NOT EFFECTIVELY PROTECT ITS CITIZENS FROM EXCESSIVE OUT-OF-STATE CREDIT CARD RATES. CONSUMERS DON'T KNOW THAT THEIR MONEY CENTER CREDIT CARD IS AT A MUCH HIGHER RATE THAN THE CARDS OF THEIR LOCAL BANKS. THUS, THE LOCAL BANKS ARE AT A DISADVANTAGE.

I AM PLEASED THAT THE DISTINGUISHED MARTHA SEGER OF THE FEDERAL RESERVE BOARD, WILL TESTIFY TODAY THAT "THE ESTABLISHMENT OF INTEREST RATE CEILINGS ON CONSUMER LOANS HAS LONG BEEN A STATE PREROGATIVE, AND ONE THAT THE BOARD FEELS SHOULD NOT BE PREEMPTED."

MR. CHAIRMAN, THE MARQUETTE DECISION HAS PREEMPTED TRADITIONAL STATE AUTHORITY IN THIS AREA; CONGRESS SHOULD RECTIFY THIS.

IN CLOSING, MR. CHAIRMAN, I WISH TO COMPLEMENT YOU ON THE CREDIT CARD DISCLOSURE LEGISLATION YOU HAVE INTRODUCED. I SEE THAT YOU HAVE ASSEMBLED AN IMPRESSIVE GROUP OF WITNESSES TO TESTIFY TODAY; I'M LOOKING FORWARD TO IT.

Senator DODD. We will have a 5-minute round of questions since there are a number of our colleagues here and so we can get through our witnesses quickly.

Let me start with both of you, just in dealing with the cap approach. As you know, I've expressed an opposition to the cap idea. My feeling is that disclosure may in fact achieve the kind of competition we would like to see and ultimately result in lowering of those rates.

I wonder if you might respond to a couple of related questions. First of all, with a cap there are various features to the credit card which affect consumer costs. The interest rate obviously is the most significant one, but certainly annual fees, grace periods, how balances are calculated and the like all have a profound effect on the cost to consumers. In fact, we have seen in other situations where the actual rate of one credit card may be substantially lower than another, but in the absence of a grace period and in the absence of an annual fee the actual impact on the consumer is more than the higher rate where a grace period and an annual fee is lower.

How do you address that particular feature. In fact if you only address the question of the interest rate and don't take into consideration those other elements which impact consumers, aren't you missing an awful major part of the consumer costs?

CREDIT CARD PRICING

Mr. FOX. We believe that if you look at credit card pricing you should look at credit card pricing and not just one element, not just credit card interest rates.

I would observe, however, that an annual fee that's clearly disclosed to consumers is something that consumers can understand. It's in dollars and cents. They know how much that's going to be out of their pocket. They don't know that with an interest rate.

The fact that there's a grace period or not a grace period, if that's clearly disclosed, that's something people can look at and with a little more education and a little more information make some sense about how that affects them more or doesn't affect them.

So an interest rate cap is a step in the right direction, but clearly Congress ought to be careful to watch for unintended consequences and ensure that the effect is not just to shift costs into a place where they may be even less easy to understand.

Mr. HOLSTEIN. Mr. Chairman, I think that if at all possible we should avoid having to regulate each and every element of this business and it would be my expectation that once you regulate the interest rate two things happen, just as happened in Connecticut.

The first thing that happens is that consumers get more tuned into the financial terms of the card offers which are laid out in the advertising presumably. The second—and most important thing is the financial terms of the credit card offer become the major point of differentiation among cards, unlike the current situation where travel and entertainment benefits, called "enhancements", become the major point of differentiation and the major selling point of cards.

As soon as you have a situation in which the financial terms become the major point of differentiation, as they are with most loans, then you have a situation in which the consumer is more tuned in and more able to make these comparisons. But consumer education is important.

Senator DODD. Obviously profits are one of the reasons that you advocate the cap approach, but certainly looking at a past record also is important. Up until just recently we've seen that credit cards have not been the most lucrative feature of what banks have offered as a part of their services. In fact, they were losers in many cases, even with relatively high interest rates.

Shouldn't you take that into consideration as well in suggesting a cap?

Mr. HOLSTEIN. Well, I think you do take that into consideration when you have the floating ceiling, assuming you set it at a point that allows for a reasonable return.

But second, I would say that no definition of a competitive market that I've ever seen calls for taking into account losses that occurred 5 to 10 years earlier. Pricing in marketplaces occurs based upon various factors that influence the market at that time, not based upon the need to make up for past losses.

Indeed, if you have a market in which an industry is making up for losses that occurred before, that to me is a sign of a lack of active competition, indeed a lack of a free marketplace.

Senator DODD. Mr. Fox.

Mr. Fox. I can't think of anything to add to that.

Senator DODD. Let me ask you one more question here. You addressed it or at least made an effort to address the question of a potential restriction of credit cards. I think credit cards are a tremendous asset to an awful lot of people. I don't want to be perceived as someone who's opposed to the notion of credit cards. It's made it possible for an awful lot of people to do things they wouldn't otherwise be able to do because of their own economic conditions and circumstances.

As a practical matter, I think one of the features you're apt to get out of a cap is in fact restriction. For poorer people there may be less availability. If you put a cap let's say of 13 percent or 14 percent on an institution, you're obviously going to reduce the margin of profit or return to that institution and they're going to be far more scrutinizing in terms of who they extend credit to. I don't know how you get around that particular point. I appreciate the fact that if you lower the rate it becomes in a sense easier for that poorer person to meet their credit obligations and I appreciate your comment on that particular point. But as a practical matter it seems to me that you get the opposite effect if you look at other examples of where you have had restrictions on charges or rates. It seems to me you end up with some discrimination in terms of people who otherwise could take advantage of that.

Mr. HOLSTEIN. Well, no one you will hear from today will be more concerned about the ability of consumers to secure credit cards than Mr. Fox and me, so that has to be one of our primary concerns. And I would be less comfortable suggesting this course of action to you were it not for the fact that consumers even today have alternatives that give them all the privileges of credit cards.

TWO ALTERNATIVES

Two examples. One is so-called secured or collaterized credit cards which are available today. They are available in this area and consumers can get a credit card even if they have either very low incomes or they have had a bad credit problem in the past. They can get a credit card with a line of credit equal to the amount they have on deposit with an institution and still have all the privileges of revolving credit and all the conveniences of the use of the card.

Similarly, a debit card, although it does not access a revolving line of credit, gives you all of the conveniences of carrying plastic instead of cash.

These alternatives would continue to exist and indeed proliferate if in fact the kind of problem you described were to occur. The fact of the matter is, if you look at any other area of consumer lending where the profit margins have decreased——

Senator DODD. I'm glad you said that. Where can that card be used? Can that card be used as broadly as, say, an American Express or VISA card, that card you're talking about for a low income person?

Mr. HOLSTEIN. Not only can it be as broadly used, but there's absolutely no marking on the card of any kind to indicate that it's any different from any other VISA or Mastercard, for example. So these alternatives do exist.

I think what would be more likely to happen is that we would see a situation in which the banks would exercise reasonable credit scrutiny, just as that which they impose now with respect to automobile loans and personal loans. I understand that those are secured loans, but that's simply an argument for having automobile loans somewhat lower in terms of the interest rate than credit card loans, but there is no reason why the disparity should be as great as it is today and no reason why lower income people would not continue to qualify for those cards provided they met reasonable standards of creditworthiness.

Mr. FOX. I think it's important to note that credit cards, particularly bank cards, are not instruments that low income people have access to today even with high interest rates. According to the most recent Federal Reserve statistics with which I'm familiar, fewer than 45 percent of all households in the United States have bank cards and when you look at that on an income decile or quintile basis it's very clear that people at the upper end of the income scale universally have bank cards. As you work down the income scale, people are less and less likely to have bank cards. So that low and moderate income households don't have bank cards today.

The proliferation in the issuance of bank cards, as Mr. Holstein pointed out earlier, has been a matter of selling additional cards to people who already have them and already have access to other bank card credit.

Senator DODD. Well, it might be interesting a little later to inquire of the witnesses who come before us what the economic profile of their average card holder is like.

Senator Gramm.

Senator GRAMM. Thank you, Mr. Chairman.

I want to focus on the usury limit because I think there's pretty much unanimity on the part of the committee that we ought to look at disclosure and we ought to try to see to the degree to which we can simplify it and provide information to the consumer, so I would like to focus my entire comments and questions on this whole idea of setting rates.

How many general credit cards are there in the country?

Mr. Fox. How many issuers of cards?

Senator GRAMM. Different issuers?

Mr. Fox. I think there are about 5,000 VISA card issuers and my guess would be a comparable number of Mastercard issuers.

Senator GRAMM. Then if you brought in all the retailers that have their own credit card, you might be talking about, what, 25,000, 50,000 issuers?

Mr. Fox. It's hard to say. They are not in most cases directly in competition with the VISA and Mastercards because the cards are only usable at a single retail establishment or single chain of retail establishments.

Senator GRAMM. But you're talking about thousands of potential competitors, even though we've heard here they are not competing. You're talking about thousands of potential competitors.

Mr. Fox. Potential, although only a handful are very large and a handful dominate the market.

Senator GRAMM. Would you say more issuers of credit cards exist in America than the normal consumer has access to grocery stores or drug stores or insurance policies on an automobile or life insurance policies?

Mr. Fox. Well, the average consumer—no consumer has access to all 5,000 or 10,000 of those credit card issuers.

Senator GRAMM. Well, answer my question. I'm living in a neighborhood——

Mr. HOLSTEIN. Senator, I think these are somewhat apples and oranges.

Senator GRAMM. If I might, Mr. Chairman, I'd like my questions answered. I'm living in a neighborhood and I have access to grocery stores. I'm also living in a neighborhood where I have the mail and I have access to credit cards. Is it not right that I have more access to more different sources of credit and general credit cards than I have access to grocery stores and to drug stores and probably to different insurance companies to insure my car, my house or my life? Is that not obvious?

Mr. Fox. No. It may or may not be obvious.

Senator GRAMM. Well, I'll answer my question. I mean, you just got through telling me there are 5,000 issuers.

Mr. Fox. Many of them may not want to sell to you because you live in a State that they don't market to. It's just like saying that there's a supermarket in California. I can't shop there just because there's a supermarket there.

Senator GRAMM. Unless you live in the neighborhood you're not going to go there. I think what is missing in your whole argument is an explanation of why, with all of these thousands of competitors, somehow somebody is not competing. If these excess profits exist, why do we not see people attempting to undercut their com-

petition by lowering rates to gain market share? Why do we not see these forces at work?

Are you saying there is collusion in the marketplace?

COLLUSION?

Mr. HOLSTEIN. Well, talking about bank cards for a second, Senator, that collusion question comes up a lot and I think it should be answered directly. No one is saying that there is outright collusion in the credit card industry. There are indeed many issuers. But as you know, competition in any industry cannot be measured solely by the number of participants. And in the credit card industry, the bank card industry, for example, nearly 45 percent of outstanding credit card debt is controlled by the top 10 issuers of credit cards.

So I think it's somewhat an apples and oranges proposition when you start talking about bank card issuers and other cards.

Senator GRAMM. That's more credit cards than we have automobile producers. Do you think we ought to regulate the prices of automobiles?

Mr. HOLSTEIN. But not more than we have automobile dealers and not more than we have automobile credit issuers, Senator.

Senator GRAMM. You believe, then—let me try and see if I can focus your thesis. Your thesis is that somehow covertly or overtly all of these issuers of credit cards, general or specific, are somehow in collusion in restraint of trade to prevent competition from occurring to eliminate excess profits. Is that your thesis?

Mr. HOLSTEIN. No.

Senator GRAMM. Well, then, why is competition not occurring?

Mr. HOLSTEIN. Competition is not occurring because of a variety of reasons, one of which is the largest issuers dominate the market and set the pace for the rest of the industry, and second, the disclosure problem of those large issuers not disclosing to the public the information they need to shop around.

But those two problems go very closely together and if the solution we are proposing indeed were flawed, we would not have more than 1,000 new issuers of credit cards in the State of Texas offering cards this year. The 14-percent cap in Texas is one of the toughest in the Nation and you would imagine that banks would be fleeing the State in record numbers and that cards would be disappearing. In fact, more than 1,000 new issuers this year will be issuing cards in Texas.

Senator GRAMM. Well, what is happening, of course, and it's the point that the chairman raised that you choose to leave out—what happens is, that if you set limits on interest rates, you have credit extended, except you have the credit extended to people who will yield a profitable rate of return at that rate and you drive the people who don't get the credit cards into the finance companies, to their brother-in-law, to the sergeant in the Army who is lending them the money double the rate paid back next week.

I see my time has expired. Since these individuals are espousing a view, I think it would be helpful to know who are the people who are funding these institutions and I would like to ask each of you if you would provide for the committee a list of the people who con-

tributed to the Consumer Federation of America and how much they gave and the Bankcard Holders of America last year?

Would you be willing to do that?

Mr. HOLSTEIN. Certainly.

Mr. FOX. Yes, sir.

Senator GRAMM. Thank you.

[The following information was subsequently submitted for the record:]

Consumer Federation of America

May 1, 1987

Hon. Christopher Dodd
Chairman
Subcommittee on Consumer Affairs
Committee on Banking, Housing and Urban Affairs
United States Senate
Washington, DC 20510

Dear Senator Dodd:

At the hearing held by the Subcommittee on April 21, 1987, Senator Gramm asked that I provide a list of contributors to Consumer Federation of America.

The following organizations are dues-paying members of the Consumer Federation of America. All are entitled to vote on CFA policies and for CFA officers and board members.

In addition to dues, CFA receives income through the sale of publications, conference registration fees, sales of tickets to an annual fundraising dinner, and honoraria for speeches given by staff members.

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ADA Consumer Affairs Committee, Washington, DC
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Arizona Consumers Council, Phoenix, AZ
Arizona Credit Union League, Phoenix, AZ
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Association of Louisiana Electric Cooperatives, Baton Rouge, LA
Association of Massachusetts Consumers, Boston, MA
Baker Electric Cooperative, Cando, ND
Basin Electric Power Coop, Bismark, ND
Black Hills Rural Electric Cooperative, Custer, SD
Blue Ridge EMC, Lenoir, NC
Broward County Commissioners, Fort Lauderdale, FL
California Credit Union League, Pomona, CA
California Labor Federation, San Francisco, CA
California Public Interest Research Group, Los Angeles, CA
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Center for Women Policy Studies, Washington, DC
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Chicago Consumer Coalition, Chicago, IL
Citizens' Utility Board of Oregon, Portland, OR
City of Anaheim Public Utilities, Anaheim, CA
City of Burbank Public Service Department, Burbank, CA
City of Farmington Electric Utility Systems, Farmington, NM
Clay Electric Cooperative, Keystone Heights, FL
Cleveland Consumer Action, Cleveland, OH
Cleveland Office of Consumer Affairs, Cleveland, OH
Colorado Credit Union League, Arvada, CO
Colorado River Energy District Association, Sandy, UT
Colorado Rural Electric Association, Denver, CO
Community Nutrition Institute, Washington, DC
Concerned Consumers League, Milwaukee, WI
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Connectict Public Interest Research Group, Storrs, CT
Consumer Action, San Francisco, CA
Consumer Affairs Association, Lawrence, KS
Consumer Cooperative of Berkeley, Berkeley, CA
Consumer Council of Maryland, Baltimore, MD
Consumer Education & Protection Assoc. for Kansans, Manhattan, KS
Consumer Energy Council of America, Washington, DC
Consumer Farmer Foundation, Inc., New York, NY
Consumer Federation of California, Westminster, CA
Consumer HELP, Washington, DC
Consumer Protection Association, Cleveland, Ohio
Consumers Cooperative Society of Santa Monica, Santa Monica, CA
Consumers League of New Jersey, Montclair, NJ
Consumers League of Ohio, Cleveland, OH
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Continental Assoc. of Funeral & Memorial Societies, Washington, DC
Colorado Public Interest Research Group, Denver, CO
Credit Union Executives Society, Madison, WI
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Department of Water and Power, Los Angeles, CA
Detroit Consumer Affairs Dept., Detroit, MI
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Senator DODD. Senator Shelby.

Senator SHELBY. Mr. Chairman, I have a chart I'd like to refer to again if I could.

Senator DODD. Certainly.

Senator SHELBY. I'll hold it up. Can you see it OK, both of you?

Mr. HOLSTEIN. Yes.

Senator SHELBY. I have a chart here that—Senator Sasser, my colleague from Tennessee, will join me here.

Senator SASSER. I would like to see this.

Senator SHELBY. I will share it with you. You can use it, too. You see how the chart is broken down with the interest rates in 1981 up to 19.5 percent or 20 percent. That's the prime rate, the green. You see how it's dropped down. We keep talking about it, but it graphically is shown here on the chart.

But at the same time, you see the credit card, the dark blue up here, interest rates remained constant just about. As a matter of fact, it shot up just a little bit over here about 1983 or something like that.

That's what you've been saying here at the table, is it not?

Mr. HOLSTEIN. It is, Senator, and not only are we saying it here but in your home State, as you well know, the legislature is grappling with it.

Senator SHELBY. My home State of Alabama.

Mr. HOLSTEIN. Indeed.

Senator SHELBY. Now the 24-month personal loan, you see the red, you see where it was up to 18.5 percent. Even that has dropped down tremendously, has it not?

Mr. FOX. Yes, it has.

Senator SHELBY. The discount rate at one time was up to 14. It's down to whatever it is there—the T-bills. I believe this chart illustrates a lot of what has been said and illustrates a lot of concerns that the consumers of America and a lot of us in the U.S. Senate have with the problem of the credit card interest rate.

Mr. HOLSTEIN. In fact, Senator, it could be argued that your chart understates the problem to some extent. It's conservative in what it lays out because, for example, it does not——

Senator SHELBY. Well, I'm a fairly conservative person, so I didn't want to overstate it but I wanted to about state it.

Mr. HOLSTEIN. Well, I think you've certainly done that and the only point I was going to make is that, as indicated in my testimony, for example, in the 1970's annual fees were virtually unheard of and now they are the norm.

DESCRIPTION OF MARKET FORCES

Senator SHELBY. Let's assume that we all believe in what my friend from Texas, Senator Gramm, says very well all the time—market forces. We want market forces to work if they're working, but when you see an obvious problem in the market—I'd call it a disruption in the market—forces aren't working for the reason of too much competition, too little competition or too much money—I don't know—but I do see a proliferation everywhere. As a matter of fact, both of my sons have got a credit card, maybe a couple of

them, in the mail. They're both in school out of town, out of State and so forth.

I see that everywhere. If that's typical—and I believe it is—you've seen a real growth of the credit card industry. As we all know, you've seen a real constant growth of the interest rates charged on consumer debt here.

If a cap was enacted, which I would hope we wouldn't put a cap on—what interest rate would you favor it being tied to or would you want it tied to something? Because money, notwithstanding what we think, it is a commodity and the supply is going to be up and it's going to be down and you all well know that or should.

Mr. Fox. My understanding is that probably one of the Treasury's securities constant maturity indexes with appropriate maturity would probably best reflect the fluctuations in cost of money and that there's some information to that effect on the record from some prior hearings a few years ago, that one of those indices probably would best be the rate that a cap ought to be tied to.

Senator SHELBY. What about just stating in plain English what the fees will be when someone applies for, or if a card is mailed out without solicitation, whatever happens?

Mr. Fox. I think it's absolutely necessary for any consumer to know the interest rate, the annual fee, the grace period whether there is one or not, and the balance calculation method at the point where they are trying to decide whether to accept the credit card or not, at the point where they are choosing between different credit cards that have been sent to them. So any disclosure legislation has to do those things at a minimum.

Senator SHELBY. What would a movement of say 3 points—or let's just use 2—2 points of interest downward on the average—what would that mean in savings to the people paying credit card bills in the United States?

Mr. Fox. Off the top of my head, over $1 billion a year, probably $1½ billion.

Senator SHELBY. $1½ billion for 2 points or per point?

Mr. Fox. For 2 points total.

Senator SHELBY. For 2 points. Thank you. My time has expired. Thank you, Mr. Chairman.

Senator DODD. Senator Sasser.

Senator SASSER. Well, thank you very much, Mr. Chairman.

Senator SHELBY. Does the Senator want to use my chart?

Senator SASSER. Yes, I would like to use it. [Laughter.]

Senator SHELBY. I will share it with you.

Senator DODD. Is there a fee involved?

Senator GRAMM. Shelby has a monopoly.

Senator SHELBY. Mr. Chairman, if the Senator from Tennessee would yield, I don't think there's a fee involved. I thought I was a fairly informed consumer here. See, it's well stated and I think we can all use this so we can understand it.

Senator SASSER. Well, I think it's an excellent chart and I want to express my appreciation to my colleague for letting me use it. I note that the source of these statistics or figures or the basis of this chart apparently are the resource is the Federal Reserve Board. And looking here at the chart, it appears that credit card interest rates are somewhere in the neighborhood of about 18.5 percent.

Now gentlemen, we talk about the rate charged on credit cards, but that doesn't tell the full story, does it? For example, there's a fee attached, an annual fee, attached to the use of these cards, isn't that correct?

Mr. Fox. That's right.

Senator SASSER. For all cards or the majority of cards? Can you amplify on that to some extent?

ANNUAL MEMBERSHIP FEE

Mr. HOLSTEIN. Senator, for most bank cards, there is an annual fee. There are two States I believe that prohibit annual fees—Texas and Missouri. Most department stores, however, do not charge an annual fee. Most gasoline cards do not charge an annual fee.

Senator SASSER. Do you know the average amount of the annual fee charged on these credit cards?

Mr. Fox. We surveyed about 1 year ago I think about 80 or 100 banks in major cities around the country and essentially found that for the basic VISA or Mastercard in almost every case the annual fee was $15 or $20, with the average right about in the middle.

Senator SASSER. So in addition to the average rate of interest of 18.5 percent, then you have superimposed on that an annual fee on the average of $15 to $20 a year. Is that a fair statement?

Mr. Fox. For the basic card and a higher rate for the premium cards or the gold cards and so on.

Senator SASSER. Now let's peel this whole thing back just a little further and let me ask you this question. When a card holder goes into the merchant and makes a purchase and charges it on the card, is the merchant reimbursed by the bank 100 cents on the dollar or is the merchant's receipt discounted by the bank?

Mr. Fox. My understanding is the amount is always discounted and that the discount can range anywhere from a couple of cents on the dollar to 5, 6 or even 8 cents on the dollar.

Senator SASSER. So then, the discount between the bank and the merchant would add anywhere from 2 percent to an additional 8 percent on the profit margin of the bank. Is that a fair assessment?

Mr. Fox. That's correct.

Senator SASSER. All right. Now some banks also charge what's known as a transactional fee on top of the fee for the card, on top of the interest rate, and on top of the differential between what the merchant is paid for the merchandise and what the bank pays him for the card. Is that right?

Mr. Fox. Transaction fees are common for cash advances. My impression, based on our limited surveying, is that transaction fees on purchases are a replacement for annual fees and not usually used in addition to annual fees. We haven't found any examples. But fairly hefty transaction fees on top of the annual fee would be applied for cash advances.

Senator SASSER. My point is that this very excellent chart here that's been produced by Senator Shelby really doesn't tell the whole story because it doesn't have included in there, the annual fees that are charged by the banks, and it doesn't have included in there the additional 2 percent or 8 percent that the bank makes by

not fully reimbursing the merchant for the full price of the merchandise. Is that correct?

Mr. Fox. That's absolutely correct.

Senator SASSER. Thank you very much.

Now another argument is made against a cap on credit cards. As you know the legislation that I propose is a floating cap, 6 percent above the Federal discount rate. At the present time, the Federal discount rate is 5.5 percent, that's what the banks pay the Federal Reserve for money. Banks won't be disadvantaged because the interest rate can go up and down.

Now an argument that's been raised against the cap on credit card interest rates that I'm proposing is that it would make less credit available to consumers.

Now, Mr. Fox and Mr. Holstein, how would you respond to that argument?

Mr. Fox. Every study that I have seen of the effect of usury ceilings has assumed a fixed rate ceiling so that there might be instances and in the recent past have been instances where the cost of money and other costs of lending pushed the total cost to the bank to a point where it was unprofitable. I'm not aware of any study that's looked at the question of a floating rate ceiling.

I would think that because a floating rate ceiling, if properly set, would provide ample margin for profit and would rise when the cost of funds rises, that there should be much less of an effect and perhaps no effect at all on the availability of credit.

Senator SASSER. Well, maybe I'm a little conservative, like my friend from Alabama, and I come from the old school and I don't believe that all consumers ought to be advanced credit. I think that credit ought to be advanced to those who are creditworthy. And it appears to me under the present credit card system, those of us who pay our bills are being asked to also pay the bills of the deadbeats who don't want to pay their credit card bills. And it's my view, quite frankly, that if we advanced credit to those who are creditworthy with these bank cards that the rates could come down very substantially and the banks who advanced the credit could make a reasonable profit which they are certainly entitled to.

Gentlemen, what do you say to this theory that everybody is entitled to a bank card?

Mr. HOLSTEIN. I find it's ironic, Senator, that normally it's the banks that come before you and offer all the reasons why they can't extend credit to this group or that group and they appear before you to argue that one of their greatest concerns is their ability to continue offering credit as widely as possible.

As I mentioned earlier, Mr. Fox and I do have to be very concerned about that because we represent the consumers and their need to have credit.

You are exactly right. There is some economic level below which consumers not only should not have credit but are poorly served if they are given credit.

Senator SASSER. It's not just economic level. There are also people who are capable of paying their bills but who don't.

Mr. HOLSTEIN. That is true.

Senator SASSER. Is that a fair assessment?

Mr. HOLSTEIN. That is correct, but presumably the 90 million or so Americans who currently carry credit cards at these high interest rates would continue to qualify for credit even in the presence or especially in the presence of lower rates. The only impact you would see is the banks having to do a better job of assuring the creditworthiness of the cards that they are currently mass marketing throughout the country to upscale magazine subscription lists and certain zip codes and so forth.

Senator SASSER. Well, gentlemen, my time has expired and I want to again express my appreciation to my friend from Alabama for allowing me to use his chart.

Senator SHELBY. Mr. Chairman, if I may, one quick observation. I didn't have those fees on there because that chart was made from statistics furnished by the Federal Reserve dealing with only the interest rate. The Senator from Tennessee is exactly right because of the other fees that is charged by various people. Thank you.

Senator GRAMM. Could you do better the next time?

Senator SHELBY. I don't believe I could do any better the next time on the interest rates. I thought that was well done. [Laughter.]

Senator DODD. Just a couple of points if I can and then if there are no other questions we'll go to the next panel.

I heard you say, Mr. Fox, briefly in response to one of Senator Sasser's questions about the other elements in the cost to consumers including the annual fees, the grace period and the like that one of the most difficult parts, which we're going to hear from all the issuers shortly about and one of their concerns about my disclosure bill, is the balance calculation. I'll be honest with you, I've tried to figure it out myself a bit. It's highly confusing to determine that.

Their point is that it's so confusing that it's probably not going to necessarily enlighten but may even further confuse.

BALANCE CALCULATION METHOD

How important is the balance calculation as part of the disclosure bill? Would it destroy the disclosure bill not to include it? I would ask both of you to respond.

Mr. Fox. Well, the balance calculation method is extremely important to many consumers in determining what the actual dollars and cents cost of a credit card is going to be. It's particularly important to those consumers who sometimes maintain a balance and incur interest and at other times pay off the balance in full because it tends to come into play most significantly when someone first invokes a balance and then maintains it for a short time.

It seems to me there are a couple of different ways that that can be handled. I agree that under present circumstances it's very confusing, difficult to explain to consumers, and that's why I believe a number of banks have taken advantage of that to essentially squeeze a few more dollars and cents out of some consumers.

There are two different ways to handle it. One would be for Congress to mandate a single balance calculation method that would be the only method that banks could use. That sounds fairly extreme but I think it's no more extreme than fair weights and meas-

ures laws that say to a grocer or supermarket this is what a pound means; this is a basic unit of measurement; you can't go around and tell consumers all they need to know is the price; they don't need to know how much is in a pound. That would be one way of doing it. You would standardize something that's an important element in cost but can't be quantified in dollars and cents and you would let banks go on and compete on the basis of dollars and cents sorts of figures like interest rates or annual fees.

If Congress does not choose to require a single balance method, then it seems to me a disclosure that was fairly tightly written in regulations so that a given institution would have a choice of three or four brief descriptions of the method, because there are really only three or four methods that I think are commonly in use—would on its face not be particularly useful, but would allow us and would allow other people to go to consumers and educate them about what that phrasing means. So that we could explain the difference between average daily balance and adjusted balance and any of several others.

I don't think we are calling for a complete blow-by-blow truth-in-lending disclosure on applications of what the method is, but a description—a very brief description of the method would enable some education and would allow consumers to eventually over a period of time learn the differences and learn which method meant what.

Mr. HOLSTEIN. I don't have much to add to that, Mr. Chairman, other than that there is some precedent for that approach. Several states, for example, currently require that a grace period be made available to a consumer regardless of whether or not the billing period was started with a zero balance.

As you probably know, right now, even if a grace period is available, in the cases of most card issuers you forfeit the grace period if you start the billing period with a carried over balance.

Senator DODD. OK. Well, we'll have to take a look at that. I have some concerns if we're going to try it with a disclosure bill and I don't know how we'll end up here. My own view is that while I appreciate the notion of moving to a cap, I happen to believe that with full disclosure at the time of solicitation, that we can achieve a reduction or at least a more realistic rate based on consumer choice. I would prefer personally to move in that direction. If we fail in all of that, obviously there are other options available to us. But it seems to me rather than move into what is a rather complicated area of setting caps and the like at this particular level which would be a change, that maybe the best way to go about it is to deal with the *Marquette* decision. As you point out it's not an unimportant point that with the decision credit card issuers located in South Dakota or wherever else and Connecticut can't affect them with our State statutes and laws at all. They make up a tremendous hunk of the business out there. The top six I think have about 25 or 30 percent of the market share because those are issuers that are not located in the State of Connecticut they are not affected by our State laws and presumably they represent one out of every four or five cards held by my consumers in Connecticut. While everyone proclaimed we did a wonderful thing in the State by setting

a cap in the State, 30 percent of my consumers weren't affected by it at all because the State statute couldn't reach the broader issuer.

That may be a better way to proceed it seems to me than the cap approach.

Do my colleagues have any additional questions?

Senator GRAMM. I would just like to ask—and you all can submit it for the record. I tried to look at some data on States that have had usury limits a long time. Arkansas, one of the neighbors of Texas, of course, is very high on the list. In fact, when I came to Congress I remember all the legislators calling me up begging the Federal Government to have a preemption of usury limits, which we did.

DIFFERENCE BETWEEN ARKANSAS AND NEW YORK

But as I look at data on Arkansas, for example, that has a cap on their interest that can be charged on credit cards of 10.5 percent, and I look at the amount of credit outstanding per household on FDIC data, I find that that level in Arkansas is almost 1/20th the level in New York State and I would appreciate your response to the following questions: No. 1, what's different about Arkansas than New York? [Laughter.]

Senator DODD. We have Congressman Schumer coming shortly. He's an expert witness in that regard.

Senator GRAMM. They're probably more frugal, I'll grant that, in Arkansas. And what happened? Why are households carrying 1/20th the credit card credit in Arkansas as they are in New York and what did they do in the way of alternatives? It's a complicated question to ask here, but I think it's the bottom line question we have to ask if we're going to go beyond trying to put information in a form the consumer can use it, which I'm very much for, if we can work out these kind of problems where it really means something.

I think ideally we would like it so that credit card marketers would have to tell how much interest they charge, somehow have some weighting system where you get in all these fees that Shelby left out creating massive confusion here. That would allow people to look at all the credit cards they can qualify for, would heighten public awareness, and help make the system work better than it is already working. When you get into these usury limits, I think you've got the answers to these questions, and any follow up you would have on trying to explain the differences that exist in a State like Arkansas and a State like New York, where people are carrying almost 20 times as much credit card credit, when one has no usury limit and the other has the lowest usury limit in the country. I know you must have looked into these problems in representing the credit card user and the consumer of America, and answering this question would be very helpful to me.

Mr. FOX. I would appreciate it if we could get a copy of that information, because I have not seen that data before.

Senator DODD. You know, in Arkansas, that is by constitutional amendment, that 10 percent.

Senator GRAMM. That is why we have all the banks in Texarkana, TX. [Laughter.]

Senator SHELBY. Mr. Chairman, I have one observation.

Senator DODD. Yes, Senator Shelby.

Senator SHELBY. When we are considering this legislation, if any, here, one other thing that would bother me, what would the compliance cost be for the issuer of the credit card, because that will be a cost of doing business, like any regulations. And I think we should always consider that. Is it going to cost a lot of money to comply with whatever regulations that we come out with or laws or regulations, and will that ultimately have to be in some way passed on to the consumer? I think that is always a central question you should address, as well as we do.

Mr. FOX. I think if you are looking at the disclosure legislation, when we see these solicitations that have these fancy four-color slick paper, eight-page brochures in them, I have to believe that somewhere on there, they could make a little room for some cost disclosure without it costing any extra money. In terms of rate caps, that depends on the mechanism that is set with a quarterly or semiannual adjustment, I wouldn't think that that would be particularly difficult to administer. Credit card operations have to be highly computerized these days and changing an interest rate is actually fairly easy in almost every case.

Mr. HOLSTEIN. Senator, I think the disclosure information before you is simply intended to close an unintended loophole in the Truth-in-Lending Act, the principles of which have been broadly supported by not only the public but the banking industry for 16 or 17 years now, and I gather that most major card issuers are not strongly in disagreement with these fundamental principles, the Truth-in-Lending Act and disclosure. We have some disagreements over some of the fine points perhaps.

Senator SHELBY. Thank you, Mr. Chairman.

Senator DODD. Thank you both very much. We have kept you a long time, and we appreciate your answers and your testimony as well.

Mr. FOX. Thank you.

Mr. HOLSTEIN. Thank you very much.

Senator DODD. We have with us, Congressman Schumer from the State of New York, a Member of the House of Representatives, a member of the House Banking Committee.

We are delighted to have you with us this morning, Congressmen. We have had the pleasure of joining together in other legislative efforts. We apologize for any delay this may have caused you in your own schedule. We welcome you to the other body, and we will be delighted to receive your testimony and, hopefully, you can respond to some questions.

STATEMENT OF CHARLES E. SCHUMER, U.S. REPRESENTATIVE IN CONGRESS FROM THE 10TH DISTRICT OF THE STATE OF NY

Mr. SCHUMER. Well, thank you very much, Senator. I am glad to be here, and I first thought to deal with Senator Gramm's question, whose home State is Texas, in terms of why there are 20 times the lending rate or the borrowing rate in New York as in Arkansas, even though Arkansas has a cap. So I suggest Senator Gramm and I go visit Manhattan and ask Bloomingdale's to open up a branch

in Fort Smith and see if the amount of lending stays the same. [Laughter.]

Senator GRAMM. I hope you have more ability to persuade them than I would have. [Laughter.]

Mr. SCHUMER. We will try.

Senator GRAMM. If we could add College Station, TX, to the list, I would be delighted.

Mr. SCHUMER. Great. [Laughter.]

In any case, I appreciate, I thank my good friend and chairman of this subcommittee, Senator Dodd, and my good colleagues, none of whom I can say are running for President, at least as I understand it, for being here today.

Senator SHELBY. Not today anyway.

Mr. SCHUMER. Not my good friend from Alabama.

I am very glad to be here today, because I think this hearing shows that our march to bring down credit card interest rates is really moving along under the able leadership of Senator Dodd.

Two years ago, I challenged the Nation's banks to justify the outrageously high interest rates they charge on their VISA and Mastercards. As the chart that Senator Shelby put together has shown, interest rates on everything else is plummeting. Mortgage rates used to be 15, 16 percent. Now they are 10, 11 percent. Auto loans are going down as low as 7 or 8 percent, when they used to be 18 or 19 percent. Even unsecured personal loans, the most risky kind of loans, far more risky than credit card interest rate loans, have dropped from 15.9 down to about 14.9 percent. And the question is, why has that happened? Why have interest rates on everything else plummeted, but not on credit cards? And I would submit that in every other one of those areas there is genuine and real competition. The free market is working.

In credit cards we have oligopoly. We have something the economists would call price leadership. There is no people gathering in a room saying—no group of bankers saying, let's keep it at 19.8 percent, but they are all winking at each other, and each bank is implicitly saying to the other, if you don't lower the rates, I won't lower the rates, and none of us will kill the goose that's laying the golden egg. And in credit cards, unlike the rest of banking, you have, indeed, an oligopolistic situation. You need millions, tens of millions of dollars to advertise to get your credit cards distributed. Mortgages—you can go shop around at your local savings banks. That is not true on credit cards.

And Senator Gramm's questioning about the free market is on target. I believe in the free market as well, but the reason that things aren't working in the credit card industry is that the free market isn't working. Similar to the automakers. Before the Japanese came in, they were competing. They were competing on the color of the car, the size of the car, the amount of leather you wanted, but not on the price. Not on the basic components. And that is just what the credit card industry is doing now.

And so what the banks say, of course, is that if they didn't charge the rates, they wouldn't make money. In October 1985, before our House Subcommittee on Consumer Affairs, the American Bankers Association testified "Allegations that banks are making exorbitant profits on credit cards are not founded in fact."

Economic Policy Institute, Washington, DC
Empire State Consumer Association, Rochester, NY
Florida Credit Union League, Tallahassee, FL
Florida Electric Cooperative Assoc., Tallahassee, FL
Florida Municipal Utilities Association, Tallahassee, FL
Florida Public Interest Research Group, Tallahassee, FL
Food & Allied Service Trades, Washington, DC
Fort Collins Light & Power Utility, Fort Collins, CO
Fund for Renewable Energy and the Enviromnent, Washington, DC
Grand Electric Cooperative Inc., Bison, SD
Greenbelt Cooperative, Rockville,, MD
Group Health Association, Washington, DC
Grundy Electric Cooperative, Trenton, MO
H-D Electric Cooperative, Inc., Clear Lake, SD
Idaho Consumer Affairs, Inc., Old Boise, ID
ILGWU, Washington, DC
Illinois Credit Union League, Oakbrook, IL
Indiana Credit Union League, Indianapolis, IN
Indiana State AFL-CIO, Indianapolis, IN
Indiana Statewide Rural Electric Cooperative, Indianapolis, IN
Industrial Union Dept., AFL-CIO, Washington, DC
Intercounty Electric Association, Inc., Mitchell, SD
Intermountain Consumer Power Assoc., Sandy, UT
International Association of Machinists, Washington, DC
International Chemical Workers Union, Akron, OH
International Molders & Allied Workers Union, Cincinnati, OH
International Union of Operating Engineers, Washington, DC
Iowa Consumers League, Des Moines, IA
Iowa Credit Union League, Des Moines, IA
League Insurance Group, Detroit, MI
Lehigh Valley Committee Against Health Fraud, Allentown, PA
Lincoln-Union Electric Co., Alcester, SD
Los Angeles County Federation of Labor, Los Angeles, CA
Louisiana AFL-CIO, Baton Rouge, LA
Louisiana Consumers League, Baton Rouge, LA
Lyon-Lincoln Electric Coop., Inc., Tyler, MN
Marine Engineers' Beneficial Assoc., Washington, DC
Maryland Citizen Action Coalition, Baltimore, MD
Maryland State & DC AFL-CIO, Annapolis, MD
Massachusetts Public Interest Research Group, Boston, MA
Michigan AFL-CIO, Lansing, MI
Michigan Citizens Lobby, Lansing, MI
Michigan Consumers Council, Lansing, MI
Michigan Credit Union League, Detroit, MI
Michigan UAW-CAP Council, Detroit, MI
Mid American Credit Union, Wichita, KS
Mire Safety Appliances Co. Employees Credit Union, Pittsburgh, PA
Minneapolis Federal Employees Credit Union, Minneapolis, MN
Minnesota AFL-CIO, St. Paul, MN
Minnesota League of Credit Unions, St. Paul, MN
Minnesota Municipal Utilities Association, Buffalo, MN
Missouri Basin Municipal Power Agency, Sioux Falls, SD
Missouri Credit Union League, St. Louis, MO
Missouri Public Interest Research Group, St. Louis, MO
Montana Public Interest Research Group, Missoula, MT
Montgomery County Office of Consumer Affairs,, Rockville, MD
Moorhead Public Service Department, Moorhead, MN
Motor Voters, Falls Church, VA
Municipal Electric System of Oklahoma, Oklahoma City, OK
Nashville Electric Service, Nashville, TN
National Alliance of Supermarket Shoppers, Great Neck, NY
Nat. Assoc. for Advancement of Black Americans in Voc. Ed., Delaware, OH
National Association of Federal Credit Unions, Arlington, VA
National Consumers League, Washington, DC
National Cooperative Business Assoc., Washington, DC
National Council of Senior Citizens, Washington, DC
National Farmers Union, Washington, DC
National Insurance Consumer Organization, Alexandria, VA
National Low Income Housing Coalition, Washington, DC
National Rural Electric Cooperative Association, Washington, DC
National Student Consumer Protection Council, Villanova, PA
National Telephone Cooperative Assoc., Washington, DC
National Women's Health Network, Washington, DC
New Jersey Credit Union League, Highstown, NJ
New Mexico Rural Electrification Cooperative Assoc., Santa Fe, NM
New York City Department of Consumer Affairs, New York, NY
New York Consumer Assembly, New York, NY
New York State Consumer Protection Board, Albany, NY
Niagara Frontier Consumer Association, Williamsville, NY
Nobles Cooperative Electric, Worthington, MN
North Carolina Association of Electric Cooperatives, Raleigh, NC
North Carolina Consumers Council, Pittsboro, NC
Northwestern RECA, Cambridge Springs, PA
Oahe Electric Cooperative, Inc., Blunt, SD
Oakland/Alameda Consumer Council, Oakland, CA
OCAW Intl. Union, Denver, CO
Office of the Consumer Counsel, Columbus, OH
Oglethorpe Power Corp., Tucker, GA
Ohio Consumers Association, Cincinnati, OH
Ohio State AFL-CIO, Columbus, OH
Oregon Consumers League, Portland, OR
Oregon People's Utility District Association, Salem, OR
Oregon State Public Interest Research Group, Portland, OR
Pennsylvania AFL-CIO, Harrisburg, PA
Pennsylvania Citizens Consumer Council, Franklin, PA
Pennsylvania Credit Union League, Harrisburg, PA
Pennsylvania League for Consumer Protection, Harrisburg, PA
Pennsylvania Rural Electric Association, Harrisburg, PA
Pentagon Federal Credit Union, Alexandria, VA
Plumas Sierra REA, Portola, CA
Public Interest Research Group in Michigan, Lansing, MI
Public Voice for Food and Health Policy, Washington, DC
Rhode Island AFL-CIO, Providence, RI
Rural Coalition, Washington, DC
Rural Electric Cooperative, Lindsay, OK
Salt River Project, Phoenix, AZ
Seattle Consumer Action Network, Seattle, WA

Service Employees International Union, Washington, DC
Sheet Metal Workers International Association, Washington, DC
Sioux Valley Empire EA, Colman, SD
Slope Electric Cooperative, New England, ND
South Carolina Rural Electric Assoc., Columbia, SC
South Dakota Farmers Union, Huron, SD
South Dakota Rural Electric Assoc., Pierre, SD
South Plains Electric Cooperative, Lubbock, TX
St. Paul Postal Employees Credit Union, St. Paul, MN
Student Consumer Action Union, Chapel Hill, NC
Tennessee Valley Public Power Assoc., Chattanooga, TN
Texas AFL-CIO, Austin, TX
Texas Consumer Association, Austin, TX
TRAC, Washington, DC
Traverse Electric Cooperative, Wheaton, MN
Tri County Electric Cooperative, Carrington, ND
Turlock Irrigation District, Turlock, CA
Turner-Hutchinson Electric Coop., Marion,, SD
UAW Local 677 Consumer Affairs Committee, Allentown, PA
United Association of Plumbers & Pipefitters, Washington, DC
United Auto Workers, Detroit, MI
United Food and Commercial Workers, Washington, DC
United Steelworkers of America, Washington, DC
Verdigris Valley Electric Coop, Collinsville, OK
Vermont Public Interest Research Group, Montpelier, VT
Virginia Citizens Consumer Council, Arlington, VA
Virginia State AFL-CIO, Richmond, VA
Washington Public Interest Research Group, Seattle, WA
Wells Rural Electric Coop., Wells, NE
West River Electric Assoc., Wall, SD
West Virgina Credit Union League, Parkersburg, WV
Wisconsin Consumers League, Milwaukee, WI
Wisconsin Credit Union League, West Allis, WI
Wisconsin State AFL-CIO, Milwaukee, WI
Wright Patman Congressional Credit Union, Washington, DC
Wyoming Credit Union League, Casper, WY

Sincerely,

Alan Fox
Legislative Representative

Many of us have been very skeptical. Last year, my staff prepared a study showing that dollar for dollar, credit card loans were five times as profitable as average bank loans. Not double as profitable, not four times as profitable, five times as profitable.

Shortly after that, we received reports from an annual meeting in Florida of credit card executives and bank executives, who run the credit card division. What was their attitude described as in some of our leading newspapers? Gleeful. About credit card profits. Just recently, newspapers reported that banks made over $5 billion in credit card profits in 1986. Still banks have refused to bring the rates down to fair levels, continuing to complain about their slim profit margins and citing their large administrative costs or the increase in postage.

Some of them say there is too much fraud, and at the same time, they are not only mailing credit cards out to Senator Shelby's kids in college, there are reported incidents of 4-year-olds getting an unsolicited credit card in the mail and dogs that had bank accounts getting credit cards in the mail. Of course. At 19.8 percent I'd give a credit card to my pet hamster and hope he would go charge as much as he could.

For years, for the 2 years I've been on this quest to get the banks to lower their credit cards, we have been looking for a smoking gun. We now have evidence. We have that smoking gun to permanently lay to rest the notion that banks are just squeezing by—squeaking by like hamsters: 19.8 percent. And we have evidence of something we long suspected, that the credit card market is behaving anticompetitively. Last month, in a hysteria over American Express' decision to offer a reasonably priced credit card at 13.5 percent, VISA's president sent a telegram to each of the 5,500 banks offering VISA cards. In the letter, VISA's president urged the banks to respond to American Express' decision to "enter one of your most profitable lines of service." Who would know better? The letter provides the banks' motives for keeping rates so high. Sheer greed.

In addition, the letter urged all banks to call American Express, express their displeasure over the new card. More important, it urged banks to "rethink your position in offering American Express products."

That, Mr. Chairman, sounds like a boycott threat to me, an action in restraint of trade that may very well be a violation of the antitrust law. And it is not the only indication we have that the credit market is not operating freely, the credit card market. Until recently, for example, every one of the Nation's major credit card issuers, if they were behaving competitively, why is the disparity between credit card rates and other rates?

It is not, as the VISA letter shows, because credit card issuers are struggling to make a profit.

I have asked Attorney General Meese and the Antitrust Division of the Justice Department to open up an antitrust investigation of VISA's behavior and the banks behavior, and I am happy to let you know that just yesterday, and I am releasing this for the first time today to the committee. I would ask consent that the letter be placed in the record.

Senator DODD. Without objection.

[The following information was subsequently submitted for the record:]

U. S. Department of Justice
Office of Legislative Affairs

Office of the Assistant Attorney General

Washington, D.C. 20530

17 APR 1987

Honorable Charles E. Schumer
House of Representatives
Washington, D.C. 20515

Dear Congressman Schumer:

This letter responds to the letter of March 18, 1987, to the Attorney General signed by you and Congressman Annunzio with which you enclosed a copy of a mailgram recently sent by the President of Visa U.S. Inc. to Visa member banks concerning the American Express "Optima" card. Your letter expressed concern that the Visa mailgram raises serious antitrust questions and you requested that the Department initiate an antitrust investigation of this area.

We agree that the Visa mailgram warrants further exploration. Accordingly, the Department's Antitrust Division has initiated an investigation to determine whether Visa's conduct, in light of the relevant circumstances, constitutes a violation of federal antitrust law.

I hope this information is of assistance to you and to Congressman Annunzio. Your interest in this matter and in the enforcement of the antitrust laws is greatly appreciated.

Sincerely,

Thomas M. Boyd

for John R. Bolton
Assistant Attorney General

TESTIMONY OF JERRY COSENTINO
TREASURER, STATE OF ILLINOIS
BEFORE THE SUBCOMMITTEE ON
CONSUMER AFFAIRS
OF THE SENATE BANKING, HOUSING
AND URBAN AFFAIRS COMMITTEE
THURSDAY, MARCH 26, 1987

Thank you for inviting me to give testimony to the Subcommittee. Events of the last several weeks have given these already important hearings added significance. The revelations regarding CitiBank's (the largest credit card issuer in the United States) attempt to create a permanent arrangement whereby it would bill its card holders for items that were not purchased, is just one example of an industry that has become dangerously intoxicated with avarice. And just this past week or so we have seen the spectacle of the American Express Company introducing a new revolving credit card with an annual percentage rate of 13.5% and a $15.00 annual fee only to be met by an attempt by VISA U.S., Inc. to mobilize the entire banking/credit card industry against it in order, no doubt, to preserve, its own usurious interest rates that average 19% nationally. (See Exhibit A)

I have been a successful businessman for thirty years. I don't like regulation but when industry either corrupts the marketplace or attempts to eliminate it then government must act. And such actions must correct wrongs industry won't correct itself. For all of the propaganda about the "free market", "government interference" etc., the real aim of the key bank card companies and their major distributors is to stifle competition, establish and maintain either through collusion or merger consumer credit monopolies that are in restraint of trade, and violate anti-trust laws while perpetuating the inexplicable situation that allows the laws of small, rural states to become, in effect, "national" laws governing consumer credit. Add this to the almost universal refusal of the major banks to fully disclose the terms of the agreements in direct mail solicitation, advertising, application forms and pre-approved credit cards. The rare instances when such terms are offered, are so incoherent as to be decipherable by noone other than an expert on credit card finance. It is for these and a number of other questionable practices that I have sent the attached letter to the Attorney General calling for a complete investigation of the credit card industry (Exhibit B).

All of this comes at a time when credit card use is so frequent that there are more than three times as many purchases made with a bank card today than there were ten years ago. The number of transactions per account is up from 18 per year in 1975 to 23 per year in 1983. In addition, bank card debt as a percent of total consumer installment debt is up since 1975. Then bank cards accounted for only 6% of all installment debt outstanding. Today bank cards account for about 14%. In short the credit card is fast becoming as indispensable as the telephone. The United States has been undergoing a major economic financial/revolution as the use of the means of exchange (cash, checks and credit cards) is radically altered. And the size of an unprecedented consumer debt, brought about by instant credit, clever marketing and merchandising of goods and services that instant credit can purchase, small monthly payments and growing credit card interest rates and other charges, is a new fact of national life.

According to the Federal Reserve Board, Americans in 1985 were indebted to the tune of $549.9 billion (nearly $2000 per person) up from $460.5 billion in 1984. And that doesn't count home mortgages. Consumer delinquency was the highest in five years. In 1984 some 284,517 Americans filed for bankruptcy. In 1985 it was 341,517. In 1986 household credit card default rates have reached its highest levels ever. In short, looming on the horizon is the third American deficit, the Consumer Deficit that joins the already enormous Federal and Trade deficits that individually and collectively pose an ominous threat to the American economy.

In Illinois, we have met with great success in reducing interest rates. When I withdrew state deposits from the First National Bank of Chicago in response to its refusal to lower its interest rates on credit cards, now one of the highest in the country, a number of events took place. First, we were able to redeposit the almost 1.8 billion dollars in annual business in institutions that will earn us a higher rate of return. Second, a number of other banks joined me and lowered their interest rates a full 6% below First Chicago's to 13.8% and another major Chicago bank inaugurated its new credit card operations with a card that carries a 12.8% interest rate. This added to American Express' introduction of its new "Optima" card at a 13.5% interest rate proves to everyone what was known by a few for quite a while, that a lower interest rate can be an effective marketing tool in attracting new business, particularly local business which can translate into several accounts besides a credit card for the consumer. Further, it demonstrates that substantial profits can be made with a lower interest rate. Finally, as the deductibility of interest on federal tax returns are phased out, the consumer is finally receiving the relief he or she so desparately needs.

The consumer credit issue is a national issue that has created national problems and most certainly requires a national policy. The national nature of consumer credit can be seen by noting that most of the major credit card issuing banks issue over half of their credit cards to out of state consumers. It is routine though it makes no sense, for example, to have a credit card issued by a New York Bank governed by Idaho law issued to an Illinois resident while he is vacationing in California. And the involvement of national companies competing for national constituencies, often leading to the unethical and, possibly, illegal policies on the part of credit card issuers, alluded to earlier, all have profound national impacts.

I applaud Congressman Schumer of New York and Congressman Annunzio of my home state, Illinois. I thoroughly endorse their legislative efforts to place a national variable cap on credit card interest rates. The Congress and the Administration can do a great deal to create a much healthier atmosphere with clear ground rules where both the credit card industry and the American consumer can thrive, two areas require immediate action. In Illinois, I have had legislation introduced that caps interest at 3% above the prime rate, a proposal that is certainly negotiable. But even if my bill was passed, an Illinois credit card issuer can simply move its credit card operation to a state like Delaware, Idaho, South Dakota etc. making the consumer credit laws of these states, as was mentioned earlier, "national" laws. In the "Alice In Wonderland" world of credit card law, the "Mad Hatter" arrangement of bank cards is such that they are subject to the laws of the state in which the bank locates its credit card operations. In passing, it should be noted that retail credit cards are governed by an entirely different set of rules. A national cap would go a long way to restoring some sanity in the pricing of credit cards so long as the interest rate was indexed to an accurate indicator of market forces.

I also applaud Congressmen Schumer's and Annunzio's efforts to press for a national full disclosure bill that requires all credit card issuers to clearly and coherently publicize the terms of the agreement on all advertising, direct mail solicitations, application forms, pre-approved credit cards and all other promotional material. This would go a long way with investing the idea of "truth in lending" with the teeth it needs to be effective.

In closing, I intend to continue in my duties as Treasurer of the State of Illinois to reward institutions with state business who successfully balance private gain with the public interest. Our collective goal must be to protect the American citizen, honor our free market system and protect the national interest. It is in that spirit that I speak to you today.

Exhibit A

(Sent by Western Union Mail-A-Gram, San Francisco, CA)

March 11, 1987

As you know, American Express announced their "Optima" non-bank credit card program yesterday. This card is positioned to be directly competitive with your Visa and Mastercard portfolios. Optima will carry a 13.5 percent interest rate and a $15.00 annual fee; however, it requires the cardholder to purchase another American Express Card (green, gold, and platinum) to qualify. The essence of this move is an attempt by American Express to further its presence in the retail banking market by acquiring additional relationship with your better customers.

What type of response might banks such as yours consider? First of all, you might call Mr. Robinson (212-640-3504) and voice your displeasure over his decision to enter one of your most profitable lines of service. Secondly, you may wish to rethink your position in offering American Express products.

I am alerting you of this development because, in my view, the Optima credit card service will have a far greater effect, in the long run, upon your banks profits than will the much publicized Discover Card which was recently launched by Sears Roebuck and Company. American Express is experienced in dealing with merchants, they have a proven product in the marketplace and they are down selling in a market rather than trying to overcome a "Sears" image.

Please take whatever steps you think best serves your banks interest.

Cordially,

C.T. Russell
President
Visa U.S., Inc.

Exhibit B

JERRY COSENTINO
TREASURER

STATE OF ILLINOIS CENTER AT CHICAGO
100 WEST RANDOLPH SUITE 15-1500
CHICAGO, ILLINOIS 60601
(312) 793-3371

March 16, 1987

Honorable Edwin Meese, III
Attorney General of the United States
Department of Justice/Room 5119
Constitution Avenue and Tenth Street, NW
Washington, D. C. 20530

Dear Attorney General Meese:

We, one as a successful businessman for over 30 years, and the other as head of the largest consumer organization in Illinois, have been partial to the forces of a free market believing governmental regulation and intervention should occur only when absolutely necessary. However, it is our view that with regard to the credit card industry such action is now mandatory.

When large, faceless and powerful private organizations abandon even the most minimal sense of business ethics, thereby undermining the confidence of the American people in the integrity of the nation's legal, economic and social arrangements, the national interest is severely compromised.

This is exactly what is occurring in the multi-billion dollar consumer credit industry. Amidst the unprecedented proliferation of bank and retail credit cards and the instant commodity and cash credit that comes with it, are "gray" areas of policies and practices imposed by credit card issuers that most certainly violate the spirit and, quite possibly, the fact of federal law. It is for this reason that we are calling upon you to launch a full fledged investigation into the entire credit card industry in general, and with particular attention to the following developments:

On March 11, 1987 C.T. Russell, President of VISA U.S., Inc., sent the attached Western Union Mail-A-Gram to banks carrying VISA and MasterCard portfolios. In response to American Express' plans to introduce its new "Optima" revolving credit card at a 13.5% annual percentage rate (APR) and a $15 annual fee, Mr. Russell suggested "First of all you might call Mr. Robinson (James Robinson III, Chairman of the Board of American Express) and voice your displeasure over his decision to enter one of your most profitable lines of service. Secondly, you may wish to rethink your position in offering American Express products." Mr. Russell closes by saying "Please take whatever steps you think best serves your bank's interests."

Exhibit B

It seems to us that such an attempt to mobilize an entire industry against a competitor with, as Mr. Russell put it, "a proven product" is acting in restraint of trade and is in violation of federal anti-trust laws. It is particularly disheartening to see such action taken against American Express for its having made available to its subscribers a credit card product whose equitable interest and other charges conform to an awakening consumer awareness that he has, for too long, been unreasonably overcharged by most major issuers of VISA and MasterCard.

The second development occurred several weeks ago and involved CitiBank, the largest issuer of credit cards in the United States. CitiBank started billing its card holders for items that were not purchased. The particular item in question was a subscription to a magazine, though the suspicion is that other items were involved or were to eventually to be sold in that fashion. It was up to the consumer to call and cancel the order, with the absence of such cancellation considered a purchase. This in itself is a cause for legal action. The effect of such a policy, if allowed to go unchallenged, could mean billions of dollars of unearned profits to credit card issuers. Such "purchases" would not only provide income from the sale but interest charges both from the larger volume on a card holder's account, the distortion of the card holder's grace period, and the confusion caused by possibly having a card holder go over his or her credit limit by being unknowingly billed for unwanted items. The effects such a policy could have on consumers is staggering, not to mention the confusion that characterizes the "rubic cube like" mystery that surrounds credit card consumer costs. Knowingly and willfully charging someone for something not agreed upon and without the purchasers knowledge is a violation of public trust and is akin to a form of theft.

Finally, with few exceptions, the entire credit card industry has never publicized the terms of the agreements of its products on application forms, advertising, pre-approved credit cards and direct mail solicitations. And on the rare occasions that agreement terms were provided they were virtually indecipherable to anyone but an expert on credit card financing. Such an industry wide practice is certainly in violation of the spirit, and possibly the fact, of the Truth-In-Lending Act.

In conclusion, consumer credit and the attendant abuses that characterize it are a national fact of life of a growing industry whose products are rapidly becoming as indispensable to Americans as the telephone. It requires a national policy that allows the marketplace to work its will in an atmosphere of trust, honor and fair play.

Very truly yours,

Jerry Cosentino
Treasurer
State of Illinois

Bob Creamer
Executive Director
Illinois Public Action Council

Mr. SCHUMER. We have a letter here that Attorney General Meese has asked, has opened up an investigation of anticompetitive activities in the credit card area. To quote from his letter:

> We agree that the VISA Mailgram warrants further exploration. Accordingly, the Department Antitrust Division has initiated an investigation to determine whether VISA's conduct, in light of the relevant circumstances, constitutes a violation of antitrust law.

And so there it is. There will be an investigation for the first time.

Now Mr. Chairman, I say that there is no question that credit card issuers have been gouging American consumers, and clearly, it is time for this 100th Congress to act and bring fairness to the credit card market, because we know that the market is not working. Surveys show that consumer awareness is not what it should be in the credit card area. They show that typical consumers believe falsely that all credit card interest rates are the same. And no wonder, when you see those big magazine ads that are advertising the color of gold or join in with the in crowd and have a VISA card.

They don't mention interest rates.

And so consumers are relatively uneducated in this area. Many don't understand that they can go out of State to a lower interest rate credit card and get the same VISA or Mastercard that has the same use and the same widespread usage in their local area at a much lower interest rate. In fact, 1½ years ago, I went on one of the morning talk shows to talk about credit cards, and I mentioned that my staff had spent weeks up at night, calling all the banks throughout the country to compile the first list of low interest rate credit cards. It was just mentioned on the show. We got something like 40,000 letters asking us for a copy of the list.

So anyone who says consumers aren't interested in finding out what the interest rates are are just not telling the truth.

If the diagnosis is credit card fiction, the cure is easy to prescribe: increased availability of credit card facts. H.R. 515, already approved by the Consumer Affairs Subcommittee in the House, and S. 616, introduced by Senator Dodd, both require credit card issuers to disclose key credit card cost information—interest rates, annual fees, grace periods, up front, at a time when consumers can use that information to make the market work.

Current law requires disclosure, but not until after the consumer receives the card and starts using it.

Mr. Chairman, I think we are at a turning point in the market. The combination of two factors, I believe, will bring interest rates down to the level they should be.

No. 1, would be the passage into law of this disclosure legislation.

No. 2, would be American Express, the first major issuer with muscle and its desire to issue a 13.8 percent credit card rate.

You put those two things together—disclosure and the fact that there will be another company with advertising muscle, with outreach, issuing a low interest rate credit card, and we will see all of a sudden the rates come tumbling down. It began about 1 year ago as a little trickle. Now it is barely a stream, but I think the dike is about to burst. The waters of the free market will flow through the

anticompetitive practices of the banks and give consumers the breaks they deserve.

I look forward to working with you, Mr. Chairman, on the legislation now before this subcommittee.

Senator DODD. I thank you very much for your very forceful, as usual, statement, Congressman, and we are particularly interested in the response of Attorney General Meese per your request regarding the investigation of the Russell letter.

A couple of questions. As you know, I am an advocate of the disclosure approach. I haven't rejected out of hand the cap approach, but I prefer to try the disclosure approach first. I am convinced, as I believe you are that there is plenty of room here for us to achieve the desired goals without going the cap route. Is that your general sense of it as well?

Mr. SCHUMER. My general sense is that now that we have American Express offering the low interest rate credit card that disclosure will do the job. I have introduced a cap bill, but I didn't push the bill in the subcommittee, because I would much prefer the free market to start working. And in fact, the cap bill I introduced was designed to get the free market going, because it said, we put a cap, a floating cap, just like Senator Sasser's bill, on credit cards, but it wouldn't take effect for 6 months, while the Federal Reserve Board did a study to see if there was competition in the rates. Once that law was passed, you can be darn sure the banks would start competing.

So I agree with you, Senator. I think that disclosure is the way to go. Our House bill, I believe, will emerge from the full Banking Committee as a disclosure bill, simply a disclosure bill.

Senator DODD. Let me ask you a couple quick sort of technical questions that come up, which we will hear later from the issuers. I don't know whether you will be able to stay around, but presumably, you have some staff who will listen, and you may want to submit some questions later, as well. One of the complaints, they will say, regarding disclosure at the time of the solicitation is the following. This is a market that is highly volatile. A lot of things are going on out there. We provide disclosure at the time of solicitation? We appreciate your wanting us to do that, but things change. By the time we actually get around to issuing the cards, the circumstances may have changed. We are not being fair to consumers when we advertise one thing, and then the marketplace may have changed what we are offering by the time the card actually arrives.

How do you respond to that concern?

Mr. SCHUMER. Well, there are ways to deal with that issue. The legislation that we have in the House says that they have to be up-to-date as to within the last 3 months. So in other words, if interest rates have gone up or down, and they want to change their rate, they have 3 months to change the advertising, et cetera. I think that is ample. What I tried to do in my disclosure legislation, and I know you tried to do in yours, was give the banks, who I might add, sometimes I wonder if they deserve it, every benefit of the doubt. And the 3 months, I think, is plenty adequate to deal with that argument.

Senator DODD. Would you define, as well, grace periods? Some of the concerns are not to disclose the grace period, because they vary from place to place. Shall we possibly define a grace period, for instance, as being no less than, say, 25 days?

Mr. SCHUMER. I think that is fine. I think one of the things one has to do in disclosure is walk a tightrope complete disclosure compared to the availability and the ease with which a consumer can understand everything. And so I think that the suggestion you make on grace period is just fine. I think consumers should know, in pretty simple terms, three things. The interest rate, whether there is a grace period, and the annual fee. All of the rest of it—and our legislation calls for that to be in tabular form on the applications and in the ads. All the other stuff can be in the fine print. That is OK.

Senator DODD. You may anticipate my question on the balance calculation. You were sitting there during my questioning of Mr. Fox and Mr. Holstein when they said that it is a complicated matter, and they made some suggestions on how to deal with it. Is it your view that if we do not include the balance calculation as part of the disclosure requirement that we would not do great harm to the disclosure effort?

Mr. SCHUMER. I agree with that and my bill doesn't have that.

Senator DODD. I thank you. Senator Gramm.

Senator GRAMM. Congressman Schumer, let me ask you, why do you think American Express took this bold action? Did they lack the greed of these big bankers? [Laughter.]

Mr. SCHUMER. Well, what I would say, Senator, is very simply that the number of people—if you already have a credit card and have a million customers at 19.8 percent, you are not going to want to crack the market and go to 13 percent, because, very simply, then you are bringing the rate down on all these other customers that you are making record profits on.

So what you need is a company that No. 1, has the expertise in the financial area, No. 2, doesn't have an existing credit card, and while American Express has a charge card, it doesn't charge any interest. So those two areas aren't conflicting. And No. 3, you need someone with muscle. I don't know if you can name for me another company that is in that situation.

Senator GRAMM. You mean, if I charge something on my American Express card and I don't pay it at the end of the month, I don't pay any interest on it?

Mr. SCHUMER. You just get your charge taken away.

Senator GRAMM. It's a damn good thing I've been paying it! [Laughter.]

Senator DODD. Wait till Bloomingdale moves to College Station. [Laughter.]

Senator GRAMM. Well, let me say, that as usual, you have given us a dramatic presentation. I am in full agreement——

Mr. SCHUMER. Senator, I had some good teachers who used to be in the House, in terms of drama. [Laughter.]

Senator GRAMM. Thank you. Thank you. [Laughter.]

I am in full agreement that if we can come up with a way to give the consumer information they can use and do it in such a way as to give them the right amount to make the decision—I guess one of

Banks' credit cards reach out and decide on buying for you

The phone rang. It all took less than a minute.

"Hello, Mr. Smith? This is—"

It was Citibank Visa calling. And a thing called Signature magazine.

And a woman, reading quickly from a script, announced the good news:

A subscription to Signature is being readied in your name, Mr. Smith, and a first-trial issue will soon be in the mail and "you don't have to do a thing" because the amount will be added to your next Citibank Visa statement" but if you should decide to cancel this subscription, Mr. Smith, all you will have to do is look for a "a special 800 number at the bottom of your next statement", and then you can call and stop it.

"Excuse me. What do I have to do if I don't want this subscription?"

"There will be a special 800 number at the bottom of your"

You probably own a bankcard or two.

Zay N. Smith

If the customer doesn't understand or maybe he's timid—and, well, he's hooked.

"And it can be quite illegal."

Signature Magazine declined comment. Citicorp spokesman Holly Chericko said it was her understanding customers "are given the choice" to buy or not, adding that "if they say no, the call is over."

But if they just listen, it's not.

Yet there were other places to check, too. A call was put through to Citibank Visa's 800 number—the general one for customer service.

The Citibank Visa operator quickly offered another 800 number. It belonged to Communications Data Services Inc., a firm in Des Moines, Iowa.

CDS is known in the industry as a "fulfillment company." It deals with customer orders, and complaints, down the line.

In other words, when you've been royally enhanced, this is where you call and demand to be fulfilled.

Nearly 60 percent of American households have invited these handy little pieces of plastic into their wallets (at up to 24 percent juice on the debt, South Dakota-style).

And you're probably used to all the breathless phone calls at suppertime, too, announcing special bankcard offers, from life insurance to carefree romps in Aruba.

Visa and Mastercard love to reach out and put the extra touch on someone. It is known as the "enhancements industry."

But now some enhancers, evidently, have decided the old ways are inefficient.

So they no longer bother to ask if you want to buy something. Because you have already bought it.

Unless you later put a stop to it.

"You know, sometimes their nerve amazes even us," said Elgie Holstein, director of the Bankcard Holders of America.

"It's not enough for a bankcard to charge 19.8 percent interest. They have to keep selling and selling.

"All this breakneck marketing, I supposed it was inevitable they'd try this."

Or let's put it another way. Bankcard phone salesmen have in the past been slick—and sometimes pushy.

Now they're pushing, at the very least, into what lawyers like to call a "gray area."

"We call this technique the 'forced-choice close,'" said Dave Robertson, a West Coast investigator who specializes in such matters.

"A salesman doesn't say 'if you want.' He says 'we're going to do.'

"And it's over before you know it. A non-denial from the customer is taken as 'yes.' And the people on the line were trained."

That question was asked.

Could you please go over the Signature call again—for a customer who's not sure if he actually bought something or not?

One operator laughed. "If you're not sure, then you bought it," she said.

A second operator was almost weary. "The magazine?" she said. "Yeah, that's what the callers have been telling me.

"See, they automatically charge it to your card. Then, if you don't like it, you call us back.

"It's coming out of your credit card and Signature magazine, kind of hand in hand."

Or wait. Maybe there was an even better place to call for fulfillment.

"One does not presume acquiescence through silence," said Bill Sullivan, chief of the Illinois attorney general's consumer protection division.

"That would seem, on the face of it, an unfair business practice—and a possible violation of the Illinois Consumer Fraud and Deceptive Business Practices Act.

"We'll be glad to look into it."

And, by the way, to all you fellow bankcard victims out there: You can get a list of bankcards that charge lower interest, and are otherwise nicer than the rest, by writing to Bankcard Holders of America, 333 Pennsylvania Ave. SE, Washington D.C. 20003.

And if your current bankcard tries one of those enhancement calls, the kind that makes you wish they'd go fulfill themselves, there is one effective way you can fight back.

Just say the magic words:

"My records indicate that you have exceeded my patience limit. Please tell me the 800 number I need to cancel my card."

the concerns I have, if you go too far with disclosure, you give people so much information that it is nonintelligible and you produce no response. I guess where I differ with you, but it is not relevant in this debate, is that I would argue that it was incentives, and in a sense, if you wanted to be crass, greed, that let someone to step out and attempt to seize more of the market, and that, in fact, what we are seeing in American Express is that the market is working. But to the degree that we can get more information to the consumer in a form that they can use it, in a form that is meaningful, I think that we can make the market work better yet, and I am in favor of that.

Mr. SCHUMER. Well, we are both in favor of making the market work as finely and as well as possible, and I only regret that it has taken so long for the market to work, including campaigns by some of us here on the Hill to start bringing awareness about this issue.

Senator GRAMM. I wish I believed that our campaigns here on the Hill had such great and far-reaching result. [Laughter.]

But if we believe it has some result in making us feel——

Mr. SCHUMER. It makes us happy; right.

Senator DODD. Senator Shelby.

Senator SHELBY. Thank you, Mr. Chairman.

Let's talk about disclosure, Congressman, just a minute.

Should disclosure to the consumer be basically simple and direct terms that people can understand, or is it going to look like four or five lawyers got together and worked a week on it, you know? [Laughter.]

Mr. SCHUMER. I would hope that the four or five lawyers in this room would not draft in their great legally craftsmanlike way legislation. I think it should be simple. I think there should be—I think, in fact, just the numbers, 19.8, 13.8, is what is needed to break the market, and I do agree, though, that we ought to have something about annual fees, just again, as a market check on someone going to 13.8 percent and then charging $100 for a credit card. People should know that.

Senator SHELBY. We have gone legislatively to mandating certain things, for the lack of a better comparison, I was thinking of tobacco, since I don't use it, on cigarettes. You know that block, they have different messages on them?

Mr. SCHUMER. Right.

Senator SHELBY. I certainly don't guess you send them out packages, but I have seen some stuff that came out, and it looks like the back of something with 44 disclosures of a typical insurance policy or something. I know that won't work with the average consumer. They will not be any better informed by that type of disclosure than they are now. So that is my concern. I do believe, like Senator Gramm has talked about, all of us, that we ought to let market forces work, if market forces will work. But they won't work unless a disclosure is simple, direct and really puts it in your lap, so to speak.

Mr. SCHUMER. I think we would be defeating our own purpose, Senator, if we didn't make it simple, as you suggest.

Senator SHELBY. And we should not whitewash anything, saying there is a problem in the credit card industry, and come back and say, well, we are not going to put a cap on it, we are not going to

do this. We are not going to come with a disclosure. A disclosure won't mean anything unless it is a good one, and if it is far-reaching; will it not?

Mr. SCHUMER. I agree with you.

Senator SHELBY. I want to ask you one last question. Was it your numbers earlier that you were saying there was a $5 billion profit in the credit card business in America?

Mr. SCHUMER. That's right. Yes; that is right.

Senator SHELBY. Is that going to help any of the big banks bail themselves out on these Third World loans, do you think? [Laughter.]

Mr. SCHUMER. You would have to ask them that, but one of the reasons, I think, that the large money center banks have had to keep credit card rates so high is because other areas of their business have been not quite as profitable, shall we say.

Senator SHELBY. The one thing that I think that we should do, and this was mentioned by the Senator from Texas earlier, and I think it is a very valid point, we should not curtail or shrink the accessibility of credit to so many working people in this country to where they will go underground to loan sharks and the sergeant that loans for ten at the end of the week and stuff like that.

Mr. SCHUMER. Right. Senator, I think what you say is exactly right, and let me say that the way disclosure should work, and if the free market will work, there will be some firms that will issue credit, as Senator Sasser had talked about before at 11 percent to just very good credit risk. And then there should be other firms that are going to issue 19—they can stay at 19 percent and continue issuing it to 4-year-olds and anybody else who wants. We shouldn't have, and this is one of the goals of disclosure legislation, uniformity. We should not have everyone issuing an 11 percent credit card, just because——

Senator SHELBY. Because everybody's got a different risk factor, have they not?

Mr. SCHUMER. That is exactly right.

Senator SHELBY. Thank you, Mr. Chairman.

Senator DODD. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

First of all, Representative Schumer, I want to compliment you for the leadership that you've shown very consistently on this whole issue. I think you have done a very constructive job in formulating credit card legislation in the House of Representatives. I do think that your efforts and those of others of our colleagues have had a significant impact in, hopefully, getting market forces to give the first indication that they are affecting credit card interest rates generally.

Now you have done, I think, a very commendable and a very exhaustive study of this whole business of credit cards, and you were indicating a moment ago that the credit card loans are five times more profitable than the average bank loan. Now I hear from some of my banking friends that there are supposedly very high administrative cost in issuing these credit cards and in servicing their customers. They offer that as a justification for the high rates and for the fees.

What do you make of this point? Are some of these credit card operations just simply very inefficient, or are they trying to offer credit to people who really are not creditworthy and perhaps should not be getting credit? What is this business about high administrative costs? Is there anything to that, or is that simply a smoke screen?

Mr. SCHUMER. I think it is a good question, Senator. I would think it is something of a smoke screen. First, as was mentioned before, some of the States that have, indeed, put on caps—Texas, Senator Dodd's State of Connecticut, and other States, have still had the banks issuing lots of credit cards, so they are making profits.

The second thing I would say is, that it is ironic that you will find many of the smaller banks have lower rates than the higher banks, and the economies of scale in this business are quite significant. In other words, if you have a million customers, the administrative cost per customer is a lot less than if you have 100,000 customers. So if administrative costs were so important, I don't think you'd see some of the very small banks issuing credit cards at interest rates much lower than the larger banks.

I think the administrative cost argument, like the fraud argument, is a smoke screen.

Senator SASSER. Now we hear a lot of talk about interest rates and what rate is being charged on the particular card itself, but we find that how the finance charge is calculated many times is much more important than the actual interest rate itself. Now that is what gives me some concern and some pause about just moving along down the road of disclosure, because when you are talking about disclosure, let's say we disclose that we are going to charge 14 percent on the bank card. That doesn't tell the full story because you've got to indicate how your calculating the finance charge, and that is going to get so complicated a figure, and so arcane, that the average consumer is simply going to be unable to comprehend it, will be misled. They will think they are paying 14 percent, when actually they will be paying a true interest rate perhaps of 17 or 18 percent.

Now how do you respond to that?

Mr. SCHUMER. Well, I think, again, it is a very good question. First, what we do in our disclosure legislation is, we just don't allow the bank to pick the method by which or the credit card issuer to pick the method by which the percentage is given. They have to do it on a standard basis. So even though they might say, well, our rate is 14 percent, but we are charging you from the exact time you bought the purchase, the legislation that we have has a uniform type of calculation. And second, the grace period which I think is important to note, particularly for consumers who don't hold out their credit for that long, would be indicated in pretty large letters.

So I think while we—you know, again, it is the tightrope we talked about. If you wanted to be exact or so precise, you might throw out the baby with the bathwater and make it unintelligible to consumers, but I think the legislation, S. 616, like H.R. 515, the bill that I have sponsored in the House, walks that tightrope pretty well.

I understand, of course, your reasons for introducing the caps, but as I said, I had introduced a bill there myself. I simply think that for two reasons, disclosure is the way to go. One, we do have some competition in the market. Two, I don't think, frankly, a cap bill at this point—I don't know what would happen in the Senate—but could pass the House of Representatives.

Senator SASSER. I see. But the bill approved by the Consumer Affairs Subcommittee does contain a cap on the credit card interest rates.

Mr. SCHUMER. Chairman Annunzio added a cap amendment to the legislation that I had introduced. It passed, but my belief is—I am quite certain of this, having counted the noses in the full committee—that amendment will be defeated, will be knocked out of the bill, and if it is not going to pass in the full Banking Committee, it wouldn't pass on the floor of the House.

Senator SASSER. Well, I suppose my attitude is that if we can get market forces to working in this whole area, and if we can get a meaningful standard disclosure, then I would find the cap less and less attractive. Perhaps the cap has been utilized to some extent as a shot across the bow of the industry in an effort to get their attention and say, look, if you don't get some competition going here, if you don't get market play in this whole area, then we are going to be forced to act legislatively. Simply, the public pressure is building up. They're saying you've got to do something to protect us against exorbitant rates because the market is not working.

Thank you very much, Congressman Schumer, for your insights here this morning.

Mr. SCHUMER. And I would simply say I agree with you, Senator, the cap is not the best way to go, but I would prefer a cap to the present situation of very little competition.

I thank the Senator.

Senator DODD. Any additional questions from my colleagues?

[No response.]

Well, Congressman, we deeply appreciate your taking as much time to be over here with us this morning, and as always, as I said earlier, your testimony is to the point, very clear, and you have done a great job on the House side. We look forward to a continuing relationship on this legislation. Thank you for being here.

Mr. SCHUMER. Thank you, Senator. Thank all of you.

Senator DODD. I am now going to call as our next witness, Martha Seger, who is a member of the Board of Governors of the Federal Reserve System. I will say to Ms. Seger, we apologize for any time delays for you this morning, but you can see deep interest among our colleagues in this legislation.

I have a copy of your statement, Ms. Seger, and I will certainly make that a part of the record, and if you would care to paraphrase your remarks, so we can get to some questions, we would appreciate that at the committee.

STATEMENT OF MARTHA R. SEGER, GOVERNOR, BOARD OF THE FEDERAL RESERVE, WASHINGTON, DC

Ms. SEGER. Well, thank you very much for inviting me today. And first of all, I apologize for a cold that has destroyed my voice,

and I hope that you can hear me. I will try to get through this, because I do have just a brief summary of the remarks that were handed in earlier. And as I said, I do appreciate this opportunity to appear before the subcommittee to discuss the legislation that has been introduced to require price and term disclosures in credit card applications and solicitations and establish a nationwide ceiling on credit card interest rates.

All of the disclosure bills that have been introduced in the Senate would add an early disclosure requirement to the Truth-in-Lending Act for credit card plans or open-end credit plans.

Generally, the Board believes in disclosure, as I personally do, and feels it is important for consumers to have adequate information to shop for credit. In considering specific disclosure legislation, such as that before the subcommittee, the Board is guided by several basic principles.

GUIDELINES OF THE BOARD

First, early disclosure rules should be structured so that they provide consumers with essential information without overloading consumers with less important information or unnecessarily raising creditor costs.

Second, the legislation should limit creditors' compliance costs by providing adequate time to comply with any new disclosure rules.

Third, any requirements that are adopted should apply evenhandedly to all competitors.

We believe that disclosing the annual percentage rate, the annual fee, and the grace period in mail solicitations would not be terribly burdensome or complex. Our impression is that many card issuers are already including in their mail solicitations much of this information and presumably have not viewed this as an impediment to advertising. Requiring extensive complex disclosures, on the other hand, may detract from the more important disclosures and increase creditor compliance cost.

Increased disclosure requirements invariably result in some increased costs to the industry. The extent of the compliances costs is largely affected by three factors. First, the breadth of the coverage of the legislation. Second, the number and complexity of the disclosures required by the legislation. Third, the amount of time that creditors are given to implement the changes required by the legislation and the implementing regulations.

Even though all the bills have the same goal, namely, to require disclosure for all types of credit cards, including bank credit cards, travel and entertainment cards and retail cards, the bills are not the same in their scope. The bills use different phrases, such as credit card accounts, credit cards, open-end credit card accounts and open end consumer credit plans. This results in different credit plans and accounts being subject to the new disclosure requirements.

The bills also vary in the number and complexity of the disclosures they require. It is important that the legislation not be broader than necessary to address Congress' concern and to insure that compliance costs for any legislation are minimized. For example, if

the concern is with credit card solicitations, we would urge that the legislation be limited to those solicitations.

We would be glad to work with your staff to ensure that the coverage of any legislation reflects the intent of the Congress.

The Board believes that one way to help control costs is to provide sufficient time for creditors to implement the changes made by the legislation. We believe the time periods provided in the bills should be lengthened to avoid unnecessary transition costs and burdens for the creditors.

One final point I would like to make is that any new disclosure requirements should apply equally to all credit card issuers. One of the bills, S. 647, applies only to banks. We believe that if additional disclosures are required for credit card solicitations, the requirements should apply equally to all credit card issuers.

I would now like to turn to the interest rate cap proposals. The credit card interest rate bills would limit the interest rate charged on any credit card transactions. S. 242 would limit the credit card interest rate to 4 percentage points above the rate established under section 6621 of the Internal Revenue Code, and S. 647 would limit the rate to 6 percentage points above the average Federal Reserve discount rate for the 6-month period preceding the determination.

The Board has commented several times on bills that would set floating ceilings on credit card rates that would supersede generally less restrictive State-imposed limits. The Board has, on those occasions, stated its opposition to those bills which are very similar to the current interest rate bills, S. 242 and S. 647. In doing so, the Board has endorsed the principle that, as with other types of credit, consumer loans are most fairly and efficiently allocated where there are no regulatory constraints on interest rates. Indeed, the Board has been concerned about the adverse impact that interest rate ceilings have had on the availability of funds in local credit markets and on individuals with limited access to credit.

ARTIFICIAL RESTRAINTS

I would like to reemphasize the Board's conviction that financial markets distribute credit most efficiently and productively when interest rates are determined in markets that are as free from artificial restraints as possible. Efforts to constrain credit card rates through Federal regulation are likely to have undesirable side effects in the form of reduced credit availability, especially for those consumers that these bills would seek to aid. Moreover these bills may encourage less efficient means of offsetting costs of credit card operations.

It should be emphasized that credit cards are issued by a broad variety of retail merchants and financial institutions that differ both as to their sources of funding and their liability structures. Under these circumstances, a single index rate would be unlikely to mirror changes in costs of funds for such a diverse array of card issuers.

In any case, short-term rates, such as the Federal Reserve discount rate, fluctuate a good deal more widely than costs of funds of most lenders. Short-term rates vary more because a lender's over-

all average cost of funds at any point is a blend of current interest rates and rates on previously issued liabilities, and because market rates on longer-term liabilities—which usually make up part of the cost of funds—typically vary less than short rates.

If the Congress should nonetheless decide to enact credit card rate legislation, the Federal Reserve strongly recommends against designating the discount rate as an index for setting credit card rates.

I would like to make a final point concerning the proposed credit card legislation. S. 241 and S. 242 require the Board to collect credit card price and term information from all credit card issuers. The Board urges the Congress not to adopt the proposed reporting requirements. There are three reasons for the Board's opposition to these reporting requirements.

First, a variety of shoppers' guides for credit cards are currently prepared by consumer groups, general circulation newspapers, including one with national circulation, and other members of the private sector.

Second, if the Congress adopts additional disclosure requirements for credit cards, more credit card price and term information will be readily available to consumers. This information can then be used by consumers to shop for credit cards and by others to prepare shoppers' guides.

Last, and possibly, most important, the reporting requirements would be burdensome and costly.

The subcommittee also asked the Board to comment on the appropriate conditions that might be required of banks that choose to change providers of credit insurance. This is a subject that the Board dealt with several months ago, when it revised the rules concerning the ability of bank holding companies to underwrite credit life and credit disability insurance.

At that time, the Board was asked by a large credit life insurance company to impose specific requirements on bank holding companies, if the holding company wanted to change credit life insurance underwriters. The Board declined to adopt the company's proposal, when the Board revised its insurance regulation last October. The Board based this decision on the belief that the concerns raised by the credit insurance company are more appropriately handled by the individual States that are charged with regulating credit life insurance and which set specific rates for such insurance.

In addition, the Board believed that the policyholders' contract rights under State law provide adequate protection.

In light of this, the Board does not believe that new requirements for banks that choose to change providers of credit insurance are necessary or appropriate. In fact, imposing a requirement such as soliciting existing insurance customers for new applications could be so burdensome as to actually preclude banks from changing underwriters.

I thank you, and I would be more than happy to answer any questions you may have.

[Complete statement of Ms. Seger follows:]

For Release on Delivery
9:30 A.M., EST
March 26, 1987

Statement by

Martha R. Seger

Member, Board of Governors of the Federal Reserve System

before the

Subcommittee on Consumer Affairs

of the

Committee on Banking, Housing and Urban Affairs

United States Senate

March 26, 1987

I appreciate the opportunity to appear before this subcommittee to discuss the legislation that has been introduced to require price and term disclosures in credit card applications and solicitations, and establish a nationwide ceiling on credit card interest rates.

Generally, the Board believes in disclosure, and feels it is important for consumers to have adequate information to shop for credit. In considering specific disclosure legislation such as that before the subcommittee, the Board is guided by several basic principles. First, early disclosure rules should be structured so that they provide consumers with essential information, without overloading consumers with less important information, or unnecessarily raising creditor costs. Second, the legislation should limit creditors' compliance costs by providing adequate time to comply with any new disclosure rules. Third, any requirements that are adopted should apply evenhandedly to all competitors.

All of the disclosure bills that have been introduced (S. 241, S. 616, and S. 647) would add an early disclosure requirement to the Truth in Lending Act for credit card plans or open-end credit plans. Even though all of the bills have the same goal -- to require disclosure for all types of credit cards, including bank credit cards, travel and entertainment cards and retail cards -- not all of the bills are the same in their scope. S. 241 deals with applications and solicitations for any "credit card account;" S. 616 requires disclosures in applications and

solicitations for "open-end credit card accounts;" and S. 647 calls for disclosures in applications and solicitations for any "open-end consumer credit plan." These different phrases -- credit card accounts, open-end credit card accounts, and open-end credit plans -- result in different credit plans and accounts being subject to the new disclosure requirements. Since the broader the coverage the greater the cost of the legislation, it is important that the legislation not be broader than necessary. We would be glad to work with your staff to ensure that the coverage of any legislation reflects the intent of the Congress.

The credit card interest rate bills would limit the interest rate charged on any credit card transactions. S. 242 would limit the credit card interest rate to 4 percentage points above the rate established under section 6621 of the Internal Revenue Code, and S. 647 would limit the rate to 6 percentage points above the average Federal Reserve discount rate for the six month period preceding the determination.

Current Law

Currently, the truth in lending law requires early disclosures for open-end credit plans and credit cards only when creditors engage in advertising. Solicitations for credit card accounts are thus subject to some truth in lending disclosure requirements, since they are considered "advertisements" under the statute and the Board's implementing regulation, Regulation Z. The creditor must give additional information about the credit plan, however, only if certain credit terms are stated in

an advertisement. For example, if the creditor advertises the plan's annual fee, the advertisement must state the annual percentage rate, as well as any other finance charges that may be imposed.

If none of the specified credit terms are stated in the solicitation, the law does not require that price and term information about the plan be given at that time. Consequently, while the act, and the Board's regulation, do at times require that consumers receive price information with solicitations, the present law does not always require that consumers be given this information before they receive a credit card.

Under the current law consumers must, however, be given full disclosure of the terms and conditions of the credit card program no later than the time that they receive the card. In addition, the regulation provides that a consumer may not be obligated on a credit program prior to receiving complete disclosures; this would include, for example, the obligation to pay an annual membership fee. Therefore, consumers do have an opportunity to review all of the terms and conditions of a credit card plan before using the card or being obligated to pay an annual fee.

The issue of how much disclosure to require led the Congress to revise the Truth in Lending Act in 1980. At that time, the Congress cut back on the disclosures required in open-end credit advertisements in the hope that reducing the disclosure burden would promote more advertising, thereby increasing competition.

Legislative Proposals

The proposed bills go beyond the present law by requiring the creditor to include certain disclosures in applications or solicitations for a credit card plan without regard to whether the creditor mentions a particular term. The proposed legislation expands the current statutory requirements for advertising in other ways as well. For example, creditors would be required to disclose whether or not any time period exists for credit to be repaid without incurring a finance charge -- a disclosure that is not required by the current advertising rules. Under S. 616, creditors would also be required to include a notice in solicitations telling consumers how the balance on which the finance charge is computed is determined. S. 647 would require the disclosure of virtually every charge that might be imposed under an open-end credit plan, including late payment charges.

To the extent that the proposed disclosure requirements might discourage open-end credit advertisements, this legislation could have the unintended effect of decreasing rather than increasing competition. We are inclined to think, however, that if the scope of the increased disclosure requirements in the bills is limited, the legislation would not have this effect. For example, we believe that disclosing the annual percentage rate, annual fee, and grace period in mail solicitations would not be burdensome or complex. Our impression is that many card issuers are already including in their mail solicitations much of this disclosure information and, presumably, have not viewed this

as an impediment to advertising. Requiring extensive, complex disclosures, on the other hand, may detract from more important disclosures and increase creditor compliance costs.

Controlling Costs

Increased disclosure requirements invariably result in some increased costs to the industry. The extent of the compliance costs are largely affected by three factors. First, the breath of the coverage of the legislation. Second, the number and complexity of the disclosures required by the legislation. Third, the amount of time that creditors are given to implement the changes required by the legislation and implementing regulations.

The bills vary in their coverage and the number and complexity of the disclosures they require. We believe that the legislation adopted by the Congress should not be broader than necessary to address the concerns of the Congress. For example, if the concern is with credit card solicitations, we would urge that the legislation be limited to those solicitations.

The Board believes that one way to help control costs is to provide sufficient time for creditors to implement the changes made by the legislation. We believe the time periods provided in the bills should be lengthened to avoid unnecessary transition costs and burden for credit card issuers.

Credit Card Ceilings

The Board has commented several times on bills that would set floating ceilings on credit card rates that would

supersede generally less restrictive state-imposed limits. The Board has on those occasions stated its opposition to those bills which were very similar to the current interest rate bills--S. 242 and S. 647. In doing so, it has endorsed the principle that--as with other types of credit--consumer loans are most fairly and efficiently allocated where there are no regulatory constraints on interest rates. Indeed, the Board has been concerned about the adverse impact that interest rate ceilings can have on the availability of funds in local credit markets and on individuals with limited access to credit.

In response to a Congressional request made last year, the Board staff prepared an analysis of the economic effects of proposed ceilings on credit card interest rates. A condensed version of the study, which appeared in the Federal Reserve Bulletin, accompanies this testimony. The following comments focus on the Board's major concerns with proposed limitations on interest rates.

An effort to establish a federally mandated ceiling on credit card interest rates would encounter substantial difficulties. From experience with the imposition of credit controls in 1980 and the sharp, unexpected contraction in consumer spending that accompanied them, we know that regulatory measures can have unpredictable and unwanted consequences. Setting a federal ceiling on credit card rates below those that currently prevail in many states would likely reduce the amount of credit made available, forcing consumers to rely instead on less convenient and possibly more expensive substitutes, or to

lose access to credit at any rate. Moreover, such a curtailment would be apt to fall most heavily on less affluent borrowers with relatively limited access to other sources of credit. The current ceiling for credit card rates under the proposed bills would be between 11.5 and 12 percent, well below the finance rates that have been typical since credit cards emerged in the early 1960s as a major method of consumer financing.

Furthermore, the imposition of stringent rate ceilings might be countered by a tightening of nonrate credit card terms by card issuers, for example, by increasing annual fees, by levying processing charges on each credit card purchase or cash advance, and by stiffening penalties for late payment or for exceeding the authorized credit limit. Some card issuers also might begin applying the reduced finance charges from the date of purchase, where permitted, rather than after the grace period expires, and might seek to increase the discount fees charged to merchants who submit credit card vouchers to them for payment.

Turning to the specific provisions of the bills before the Congress, it should be emphasized that credit cards are issued by a broad variety of retail merchants and financial institutions that differ both as to their sources of funding and their liability structures. Under these circumstances, a single index rate would be unlikely to mirror changes in costs for such a diverse array of card issuers. In any case, short-term rates, such as the Federal Reserve discount rate, fluctuate a good deal more widely than costs of funds of most lenders. They do so because a lender's overall average cost of funds at any point is

a blend of current interest rates and rates on previously issued liabilities, and because market rates on longer-term liabilities -- which usually make up part of the cost of funds -- typically vary less than short-term rates.

If the Congress should nonetheless decide to enact legislation, the Federal Reserve strongly recommends against designating the discount rate as an index for setting ceilings on credit card rates. The discount rate, as you know, is the interest rate charged by the Federal Reserve Banks on extensions of short-term credit to depository institutions. Because it typically applies to very short-term loans, the discount rate is an inexact measure of either marginal or average costs of loanable funds, which may reflect a wide range of maturities. Furthermore, the discount rate is a tool of monetary policy. As such, it is an administered rate that reflects broad policy considerations that frequently are complex, and so may deviate from other market rates, even those for instruments of comparable maturity. It would be wrong, in the Board's view, to employ a tool of monetary policy for this issue.

Another question at issue is whether any regulation of credit card interest rates is more appropriately a matter for federal or for state intervention. In contrast to efforts at the federal level to assure the safety and soundness of financial institutions, the establishment of interest rate ceilings on consumer loans has long been a state prerogative, and one that the Board feels should not be preempted. In recent years, virtually every state has reviewed and overhauled its laws

regulating consumer interest rates. After studying the situation in their own jurisdictions, many of these states have opted to raise or remove interest rate ceilings for credit card borrowings. The Board respects the collective judgment of a growing number of states that higher--not lower-- ceilings are appropriate to assure that an adequate supply of credit card services is available from lenders located there. Of course, these states retain the authority to lower or restore ceilings if convincing evidence of excessive rates appears.

In closing, I would like to reemphasize the Board's conviction that financial markets distribute credit most efficiently and productively when interest rates are determined in markets that are as free from artificial restraints as possible. Efforts to constrain credit card rates through federal regulation are likely to have undesirable side effects in the form of reduced credit availability, especially for those consumers that these bills would seek to aid. Moreover, they may encourage less efficient means of offsetting costs of credit card operations. Accordingly, the Board concludes that it would be inappropriate to impose a federal ceiling on credit card rates.

The Economic Effects of Proposed Ceilings on Credit Card Interest Rates

This article was prepared by Glenn B. Canner and James T. Fergus of the Board's Division of Research and Statistics. Patricia A. Boerschig, Julia A. Springer, and Janice S. Westfall provided research assistance. Footnotes appear at the end of the article.

Most interest rates have fallen substantially since the early 1980s, but those on credit card debt have changed relatively little. This disparity has led to assertions that credit card rates are excessive in view of the decline in funding costs of card issuers. As a result, several bills were considered in the Congress in 1986 that would have imposed a nationwide rate ceiling on credit card accounts.

This article focuses on issues raised by the proposed federal limits on credit card rates, including the likely effects of such ceilings on the availability of credit card services to different groups of consumers. It also explores the consequences, for consumers, of possible creditor responses to rate ceilings such as modifying nonrate prices of card services, altering other terms on credit card accounts, and raising prices on merchandise.

Effects on the Profitability of Credit Card Plans

The nationwide ceilings on credit card rates suggested in recent congressional proposals would be more restrictive, on the whole, than the various maximum credit card rates that already exist in many states (table 1). A comparison of typical rates charged on bank credit cards during the 1972–86 period with the ceiling rates that would have applied under either of two proposed bills, S.1603 and S.1922, is presented in chart 1. The Senate bills take an approach similar to that of two bills introduced in the House. Had either Senate bill been in effect, the more restrictive rate limit would have cut bank card rates during most of the period, and in the absence of compensating changes, it also would have reduced bank card revenues. Rates for retail store credit cards generally have been in line with those of bank cards, so the proposed federal ceilings likely would have reduced revenue for retail credit card plans. Both bank and retail store credit card services and pricing probably would have been altered in reaction to a large cut in revenue. The scope of such adjustments depends to a great extent on current and expected profits on credit card services.

Historical Evidence on Profits

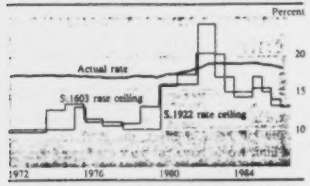
The annual net earnings of bank card plans before taxes averaged 1.9 percent of balances outstanding from 1972 through 1985.[1] Over the

1. Characteristics of legislation considered in the U.S. Senate in 1986 to impose a national ceiling on credit card rates[1]

Characteristic	S. 1603, National Credit Card Protection Act	S. 1922, Credit Card Holder Protection Act
Index	Six-month Treasury bills, average investment yield for preceding calendar year	IRS rate payable on overdue income tax payments and on income tax refunds, calculated by IRS from prime rate charged by commercial banks during an earlier six-month period
Markup	5 percentage points above index rate	4 percentage points above index rate
Current ceiling	13.085 percent for all of 1986	14 percent for January through June 1986; 13 percent for July through December 1986

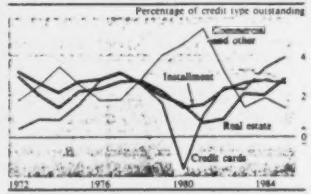
1. 99 Cong. 2 Sess.

1. Average actual finance rate on bank credit card plans and maximum rates with proposed ceilings[1]



1. Actual rate is an average of the most common rate charged on bank credit card plans by commercial banks reporting to the Federal Reserve.

2. Net earnings before taxes on various types of bank credit[1]



1. Based on annual data from the Federal Reserve's Functional Cost Analysis.

same period, average net returns on other major types of commercial bank lending were significantly higher: 2.3 percent on real estate mortgages, 2.4 percent on consumer installment debt, and 2.8 percent on commercial and other loans. Of course, there have been substantial year-to-year variations. For example, the average profitability of bank cards rose to 3.4 percent in 1984 and to 4.0 percent in 1985—a high for the 1972–85 period. However, before 1984 the profitability of bank card plans often was low relative to that of other major types of bank lending (chart 2). Thus, the more reliable indicator of long-run bank card profitability seems to be an average derived from periods of low as well as high profitability rather than from the atypical experience of recent years.

Annual data on earnings of retail card plans are not available. However, two national surveys of retailers were conducted on behalf of the National Retail Merchants Association in 1968 and 1985 and a study of retailers in New York State was made in 1973. The studies indicate that on average—not considering profits on associated merchandise sales—such credit card plans consistently operated at a loss.[2]

The unusually high level of bank credit card profits in 1984 and 1985 is subject to differing interpretations, and definite conclusions will require additional evidence. But the most likely explanation involves a combination of favorable economic trends and structural changes in credit card regulation. Credit card profits clearly benefited from the drop in funding costs in recent years. Although such costs constitute a much lower proportion of total costs for credit card operations than for other major types of bank lending, the sharp decline in market interest rates has contributed significantly to the recent improvement in profits on credit card plans. In addition, the relaxation or removal of regulatory constraints on credit card interest rates in many states in the early 1980s has helped increase profits. These actions were taken after credit card issuers experienced a severe squeeze on profits in the 1979–81 period.

Another factor in the 1984–85 rise in bank card profitability was the major improvement in the quality of issuers' credit card portfolios following the economic disruptions of the late seventies and early eighties. Credit card issuers responded to falling profits by adopting much more selective credit standards in an effort to control costs. Also, many credit card accounts were terminated because of delinquencies and payment defaults. Because the remaining account holders were relatively good credit risks, delinquencies fell to a historically low level in early 1984. As credit card issuers generally have returned to less restrictive credit standards and as some issuers have undertaken aggressive marketing programs, collection problems have increased again. But such problems remained at low to moderate levels throughout 1984 and early 1985.

It seems doubtful that the increase in profitability reflects diminished competition in the credit card industry in light of the number and variety of credit card issuers. Competing credit

card plans within an area often include those offered by several regional and national firms in addition to those of local retailers and financial institutions. The diversity of credit card pricing schemes, the heavy volume of solicitations, and the pace of entry by new competitors seem inconsistent with a general absence of competition. Moreover, the rapid development of competing sources of revolving credit—such as lines of credit secured by residential equity and overdraft credit lines on checking accounts—reinforces competitive pressures on the credit card industry. These considerations suggest that the recent high levels of bank card profits are unlikely to persist. Thus, longer-term profit experience seems to provide a more reliable basis for evaluating the need for regulation of credit card rates.

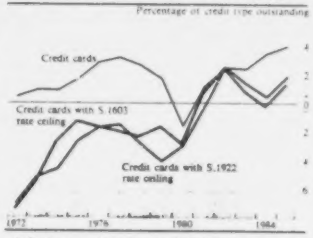
In sum, the evidence suggests that profits on credit card plans at banks typically have been low, while those on retail credit plans generally have been negative. Therefore, it seems unlikely that card issuers could absorb significant reductions in revenue from finance charges over the long term merely by accepting lower profits.

Estimates of Profitability under Proposed Rate Ceilings

Estimates based on data from the Federal Reserve's Functional Cost Analysis for commercial banks suggest the extent to which bank card profits could be cut by the proposed nationwide rate ceilings. Each of the lower lines in chart 3 shows an estimate of net earnings before taxes on bank credit card plans as a percentage of credit outstanding, assuming that one of the nationwide rate ceilings proposed in S.1603 and S.1922 had been in effect. The top line on the chart shows the actual profit experience of commercial bank credit card lending, as previously shown in chart 2.[1]

According to these estimates, bank credit card plans would have lost money in 10 of the 14 years from 1972 through 1985 under the rate ceilings in either S.1603 or S.1922 and would have earned only marginal profits in two of the years. These estimates suggest that if such rate ceilings were enacted, the pressures to make cost and revenue adjustments would be intense.

3. Net earnings before taxes on credit card plans and estimated earnings under proposed rate ceilings[1]



1. Based on annual data from the Federal Reserve's Functional Cost Analysis.

Credit Card Use and Repayment Patterns

Some of the changes that credit card issuers might make in response to reduced profitability include cutbacks in the quantity and quality of credit card services, increases in nonrate credit card prices, and boosts in retail prices for some types of merchandise. The ways such changes affect consumers depend on two factors: the prevalence and the manner of credit card use. First, changes in the availability and pricing of card-related services mainly affect consumers who use credit cards—although, as explained later, some indirect effects may be broader. Second, the effect on credit card holders depends on how they use their cards because some credit card fees and charges apply only to consumers who use their cards in particular ways—for example, to obtain cash advances or for long-term borrowing. Accordingly, information about use of credit cards by particular consumer groups is a key to evaluating the impact of a nationwide credit card rate ceiling.

Credit Card Use

During the past two decades the Survey Research Center at the University of Michigan has monitored the use of credit cards. The most recent data are for 1983. Overall, 62 percent of all

2. Proportion of U.S. families with selected characteristics that use various types of credit cards, selected years, 1970–83

Family characteristic	Any credit card			Retail card		Bank card		
	1970	1977	1983	1977	1983	1970	1977	1983
Family income (1982 dollars)								
Less than 5,000	13	21	18	13	14	2	8	4
5,000–7,499	19	28	23	19	23	3	6	12
7,500–9,999	19	27	33	22	28	5	7	12
10,000–14,999	31	41	49	31	40	7	13	26
15,000–19,999	46	54	64	47	55	12	20	36
20,000–24,999	58	66	73	57	62	15	31	46
25,000–29,999	62	72	79	65	67	21	41	49
30,000–39,999	72	78	87	68	76	23	53	61
40,000–49,999	78	87	88	76	81	25	58	69
50,000 or more	82	91	95	79	83	28	73	80
Age of head (years)								
Less than 25	42	59	58	39	52	12	18	26
25–34	61	80	84	60	72	20	46	57
35–44	57	82	73	63	63	23	49	52
45–54	48	68	69	56	62	23	46	45
55–64	44	62	72	52	62	19	42	42
65–74	37	48	58	39	53	7	31	37
75 or more	30	34	35	25	36	3	13	18
Education of head								
0–8 grades	21	30	30	24	28	5	13	12
9–11 grades	34	49	49	39	38	9	23	24
High school diploma	58	62	62	57	57	18	42	45
Some college	70	78	78	66	72	28	61	67
College degree	82	89	90	73	77	34	69	78
Occupation of head								
Professional or technical	n.a.	84	83	73	80	31	59	63
Manager	n.a.	86	86	72	77	30	57	62
Self-employed manager	n.a.	69	75	59	64	18	43	48
Clerical or sales	n.a.	80	78	59	65	21	47	51
Craftsman or foreman	n.a.	64	73	50	57	16	39	44
Operative, laborer, or service worker	n.a.	61	61	42	46	10	28	34
Farmer or farm manager	n.a.	35	37	24	29	7	15	27
All families	39	49	52	39	44	15	35	44

families reported using credit cards in 1983 (table 2). Fifty-four percent used one or more retail store cards, 40 percent at least one bank card, and 26 percent at least one gasoline card. Regardless of the type of credit card, use rises sharply and continuously with family income and with the level of education of the family head.

Retail store cards are the most widely used type of credit card. Their use is significantly more widespread than that of bank cards except among families with incomes of at least $50,000 or which are headed by persons with a college education. However, the use of bank cards has been expanding rapidly in every family category of income, age, education, and occupation—more than doubling from 16 percent of all families in 1970 to 40 percent in 1983. By contrast, the proportion of families that use retail cards has increased much more slowly, from about 45 percent in 1971 (not shown) to 54 percent in 1983. The more rapid growth in bank card use may reflect to some extent a substitution of credit card borrowing for other types of installment credit that do not provide flexible repayment terms. It may also reflect abandonment of proprietary credit card plans and 30-day credit programs by some gasoline companies and retail merchants or acceptance of bank credit cards by such firms in addition to the credit arrangements they offer.

Repayment Practices

Analyzing the effect on consumers of the proposed ceilings on credit card rates requires information about the use of the revolving debt feature available with bank and retail cards (an option usually not available with gasoline or travel and entertainment cards). Most revolving credit plans do not charge interest if the card holder pays the full amount billed before expira-

2. Continued

Family characteristic	Gasoline card			Travel and entertainment card		
	1970	1977	1983	1970	1977	1983
Family income (1982 dollars)[1]						
Less than 5,000	7	9	5	1	*	*
5,000–7,499	9	8	6	2	*	2
7,500–9,999	11	11	10	2	1	2
10,000–14,999	18	16	16	4	1	3
15,000–19,999	28	26	19	8	2	5
20,000–24,999	33	30	22	7	2	6
25,000–29,999	42	32	31	12	3	10
30,000–39,999	50	41	40	10	10	13
40,000–49,999	57	54	43	13	12	14
50,000 or more	68	67	61	34	31	17
Age of head (years)						
Less than 25	23	12	8	5	2	3
25–34	41	31	20	10	7	10
35–44	39	42	30	11	12	13
45–54	39	39	30	12	12	10
55–64	34	34	37	10	6	11
65–74	23	27	26	6	3	5
75 or more	10	16	13	3	4	*
Education of head						
0–8 grades	14	12	8	3	1	1
9–11 grades	23	18	16	4	2	2
High school diploma	36	29	19	9	4	4
Some college	42	37	30	13	12	11
College degree	68	63	53	22	21	27
Occupation of head						
Professional or technical	n.a.	56	43	n.a.	14	19
Manager	n.a.	54	44	n.a.	22	25
Self-employed manager	n.a.	48	40	n.a.	19	19
Clerical or sales	n.a.	34	30	n.a.	7	11
Craftsman or foreman	n.a.	29	23	n.a.	3	4
Operative, laborer, or service worker	n.a.	16	15	n.a.	3	3
Farmer or farm manager	n.a.	18	18	n.a.	4	1
All families	34	32	26	9	7	9

*Less than 0.5 percent.
n.a. Not available.
1. For each survey year, income is for the preceding calendar year.
Source: George Katona, Lewis Mandell, and Jay Schmiedeskamp, *1970 Survey of Consumer Finances*, University of Michigan, Institute for Social Research, 1971; Thomas A. Durkin and Gregory E. Elliehausen, *1977 Consumer Credit Survey*, Board of Governors of the Federal Reserve System, 1978; Robert B. Avery and others, *1983 Survey of Consumer Finances*, Board of Governors of the Federal Reserve System, forthcoming.

tion of a specified interest-free period called the grace period.[4] (Cash advances typically earn finance charges from the transaction date.) Thus, unlike most other kinds of credit, the way the credit card holder uses the account determines whether the account produces any interest income for the card issuer and, if so, how much.

Consumer surveys indicate that credit card users fall into two categories—convenience users and borrowers—according to their customary repayment practice. Convenience users are those who usually pay off their balance in full during the grace period, thereby avoiding finance charges; they use a credit card primarily for the convenience it affords in conducting transactions. Borrowers are those who usually do not pay off their balance in full during the grace period, thereby incurring finance charges. Card users may occasionally choose to deviate from their usual repayment pattern: convenience users may repay a particularly large purchase in installments; borrowers may sometimes repay the outstanding balance completely.

Responses by consumers to questions about their repayment practices have been consistent over time. In 1983, as in 1977, about half of families that used bank or retail credit cards stated that they nearly always paid their bills in full each month (table 3). Such consumers can be considered convenience users. The remaining families were about evenly divided between those that sometimes paid their bills in full each month and those that hardly ever repaid their entire outstanding balance by the end of the billing cycle.

Repayment patterns vary considerably according to the characteristics of consumers. For example, convenience use rises sharply with the age of the household head. Nevertheless, substantial proportions of families in each income and education category reported that they nearly always paid off their entire outstanding balance in full each month.

3. Distribution of families with selected characteristics that use bank or retail credit cards, by repayment practice, 1977 and 1983[1]

Percent

Family characteristic	Nearly always pays in full		Sometimes pays in full		Hardly ever pays in full	
	1977	1983	1977	1983	1977	1983
Family income (1982 dollars)[2]						
Less than 5,000	34	42	26	19	15	19
5,000–7,499	52	45	18	23	13	16
7,500–9,999	43	51	29	21	13	13
10,000–14,999	64	48	19	28	8	14
15,000–19,999	41	49	24	24	15	13
20,000–24,999	53	54	24	23	13	13
25,000–29,999	53	54	24	23	13	13
30,000–39,999	58	58	23	23	10	10
40,000–49,999	61	61	21	21	9	9
50,000 or more	71	71	17	17	6	6
Age of head (years)						
Less than 25	47	47	37	37	11	11
25–34	47	47	32	32	15	15
35–44	48	48	29	29	15	15
45–54	58	58	23	23	13	13
55–64	61	61	21	21	9	9
65–74	58	58	24	24	9	9
75 or more	54	54	23	23	14	14
Education of head						
0–8 grades	37	37	33	33	20	20
9–11 grades	48	48	33	33	19	19
High school diploma	54	54	29	29	17	17
Some college	41	41	34	34	25	25
College degree	58	58	28	28	14	14
Occupation of head						
Professional, technical	57	57	30	30	13	13
Manager	59	59	28	28	13	13
Self-employed manager	45	45	36	36	19	19
Clerical or sales	48	48	34	34	18	18
Craftsman or foreman	61	61	28	28	11	11
Operative, laborer, or service worker	48	48	32	32	20	20
Farmer or farm manager	58	58	33	33	9	9
All families that use bank or retail cards	49	47	28	28	23	25

*Less than 0.5 percent.
1. The 1977 survey covered 2,563 families, of whom 1,444 had bank or store cards. The 1983 survey covered 3,824 families, of whom 2,087 had bank or store cards.
2. For each survey year, income is for the preceding calendar year.
Source: Durkin and Elliehausen, *1977 Consumer Credit Survey*; Avery and others, *1983 Survey of Consumer Finances*.

Possible Adjustments by Card Issuers and Effects on Consumers

Those who stand to benefit from a nationwide limit on credit card rates are credit card borrowers, who would incur lower finance charges. However, as noted, the low average profitability of bank and retail credit card plans suggests that card issuers would likely reduce costs and seek more revenue from alternative sources under the proposed nationwide interest rate ceilings. These adjustments by issuers would erode some of the benefits to borrowers and impose costs on other consumers. Although specifying the responses that card issuers might choose is difficult, there are several likely possibilities (table 4).

Restricting the Availability of Services

Perhaps the most obvious cost-cutting step that credit card issuers might take is to tighten credit standards so as to reduce collection costs and

4. Proportion of selected groups of credit card holders affected by possible responses by bank and retail credit card issuers to more restrictive interest rate ceilings[1]

Type of response	Bank card holders		Retail card holders	
	Convenience users	Borrowers	Convenience users	Borrowers
Availability adjustments				
Tighten credit standards[2]	Some	Some	Some	Some
Reduce or eliminate services[3]	Some	Some	Some	Some
Pricing adjustments[4]				
Reduce or eliminate interest-free period	All	Some	All	Some
Alter method for calculating balance on which finance charge is based	None	All	None	All
Increase retail price of merchandise	All	All	All	All
Increase merchant discount fee (to the extent reflected in higher retail merchandise prices)	All	All	All	All
Start charging, or increase, an annual fee	All	All	All	All
Charge a fee for each transaction	All	All	All	All
Charge a penalty fee for exceeding credit limit	Few	Some	Few	Some
Charge a penalty fee for each late payment	None	Some	None	Some
Charge a fee for each cash advance	None	Some	None	Some
Charge explicitly for services previously provided without charge	Some	Some	Some	Some

1. Convenience users typically pay off their balances during the interest-free period, thus avoiding finance charges. Borrowers typically do not pay off their balances during the interest-free period and therefore usually pay finance charges.

2. Tighter credit standards ordinarily would be implemented by raising the minimum score necessary under a credit-scoring system to qualify for a credit card or by offering a higher credit limit. Factors that have positive weights in most credit-scoring systems include an applicant's income, assets, duration of residence and employment, and previous credit record.

3. Financial institutions might curtail ancillary services that some customers presently receive free of charge. Servers issues on credit card charge-offs. Such a change would affect mainly applicants for new credit card accounts. However, holders of existing accounts could also be affected by more stringent enforcement of credit limits and by any increase in minimum payment requirements.

Changes in the availability of credit would have the greatest potential effect on "marginal" card applicants, who meet the current minimum requirements for holding a credit card account—such as income level, employment tenure, duration of residency, and previous credit record—but who would not qualify for credit if such standards were stiffened considerably. Although credit decisions are based on many criteria, lower-income persons who apply for credit cards—including recent entrants into the job market and those with low levels of education and skills—are likely to be affected more seriously by tighter credit standards than those with greater resources.

In addition, financial institutions might curtail credit card enhancements that some of them offer. Such features include protection programs that indemnify credit card holders for charges made with lost or stolen credit cards, discounts on transportation and lodging, rebates on purchases billed to a credit card account, and provision of emergency cash to travelers. If the pressure on profits became severe, some institutions might eliminate their card plans and redirect resources into more profitable lines of business. Retail firms might discontinue in-house plans, with the result that customers would need to rely instead on bank credit cards or other sources of financing. Although elimination of credit card operations is an extreme measure, some retailers and financial institutions in the early 1980s did curtail or discontinue credit card services in an effort to stem losses.

4. The ability of card issuers to make some of these adjustments may be constrained by competition or by state law.

5. Financial institutions and retailers might institute fees for services such as processing credit card applications, replacing lost cards, providing more than one credit card, and sending out each statement. Retailers might begin charging for other services that previously had been provided free of charge.

Raising the Prices of Services or Merchandise

An alternative or complementary way of offsetting reduced interest income is to reprice credit card services. One such change would be to shorten or eliminate the grace period that credit card issuers typically have allowed, although such action would not be possible in states that require a minimum grace period.

Regulations that reduce finance rates would help many credit card borrowers, who would incur smaller finance charges, but that benefit would be offset by the additional finance charges that many convenience users would pay because of curtailments in grace periods. In addition, those borrowers who sometimes make full payment and at such times avoid incurring finance charges also would be adversely affected by a cutback in grace periods.

As previously noted, a large proportion of lower-income credit card users are convenience users. Among card users with less than $10,000 in family income, 48 percent reported in 1983 that they customarily paid off their outstanding balances each month. An additional 24 percent of lower-income families reported sometimes paying their balances in full. Thus, even among lower-income families, the overall effect of lower rate ceilings combined with shorter grace periods is not clear.

Furthermore, because a substantial proportion of higher-income consumers are convenience users, the net benefit of restricting credit card interest rates also is unclear for them. However, the balance of benefits and costs for the elderly is likely to be negative if issuers shorten or eliminate grace periods on credit cards in response to tighter credit card rate ceilings. Among families headed by persons 65 years or older, convenience users of credit cards constituted three-fourths of credit card users.

A second major type of repricing, available only to retail credit card issuers, is to increase merchandise prices in an attempt to offset all or part of a reduction in finance charge revenue. The feasibility of this response for particular retail firms would depend mainly on the types of merchandise sold because competition from cash-only merchants might limit price increases to goods that usually are purchased on credit. In this case, only customers who pay in cash for such merchandise would subsidize the cost of providing credit services.

Although increases in merchandise prices can be implemented only by retailers, some issuers of bank credit cards might be able to effect an indirect form of repricing by raising the fee they charge merchants for processing credit card sales. The fee, called the merchant discount, is an operating cost to the retailer. Any increase in these charges could be passed on in higher prices of merchandise, including prices paid by customers who always pay in cash. However, competition with other card issuers, not only for processing credit card charges but also for other merchant business such as demand deposits and loans, could limit the ability of banks to increase the merchant discount fee.

Other card-related fees could also be raised. Seventy percent or more of commercial banks in 1985 charged an annual fee for MasterCard and Visa accounts.[5] These annual fees could be increased to help generate higher revenue, and additional institutions could implement such fees. Changes of this kind would affect all card holders.

A similarly pervasive effect would occur if a fee for each transaction were charged by card issuers. As of 1985 only about 3 percent of the MasterCard and Visa issuers charged such fees.[6] With the exception of some gasoline company credit card plans with enhancements, no retail card issuers are known to be charging annual fees or fees for each transaction. However, apart from legal restrictions on fees that exist in a few states, the main barriers to such a practice appear to be the force of competition and customary practice in the retail industry.

Some credit card issuers charge a fee when an account balance exceeds the established credit limit or when problems arise such as late payments or returned checks. Late charges were levied in 1985 by 50 percent or more of commercial banks that issue MasterCard and Visa accounts.[7] By definition, convenience users typi-

Senator DODD. Thank you very much for your testimony. Let me, at the outset, express my gratitude to the Fed. They have been very, very helpful on this legislation now going back a couple of years. We have had extremely constructive comments and suggestions, and we look forward to a continuing relationship with the Fed as we try and develop specific language and improvements in the bill itself.

In your testimony, you cite the historic support for two propositions—that is, the Fed's historic support for two propositions. One, that credit is most fairly and efficiently allocated where there are no regulatory constraints, and two, that the Board does not believe that State regulation of interest rate ceiling should be preempted by the Federal Government. Now those have been two historic positions they have taken.

If my memory serves me correctly, the Board has always taken the position that when these two principles are in conflict, that the State law should control.

Is that correct?

Ms. SEGER. I can't speak going back too far into history, but in the roughly 3 years I've been here, that's generally been the case.

Senator DODD. Well, you've heard testimony, I presume you have, anyway, from a couple of our first witnesses, from Mr. Fox and Mr. Holstein, that talked about the *Marquette* decision with regard to the State of Connecticut and the State of Texas. I gather other States have adopted ceilings at the State level. Obviously, one of the problems is that the *Marquette* decision allows for exporting, if you will, of rates across State lines.

POSITION OF FED ON MARQUETTE DECISION

What is the position of the Fed with regard to the *Marquette* decision? Should we legislatively overturn that decision so that States, if they decide to move in that direction, would be able to deal with the question of rates more effectively?

Ms. SEGER. I have not discussed this specifically with my colleagues, but my suspicion is, and I will just call it that, is that we would probably support the *Marquette* decision. It is what encouraged Citibank, I believe, to move out of New York State, which had a very burdensome and onerous usury situation in the late 1970's and go into South Dakota, which deregulated. And South Dakota used that as a economic development tool, and this is, in my judgment, what kicked off the whole approach toward deregulation of usury ceilings in a number of States.

Senator DODD. Isn't that somewhat contradictory, however, with these two historic positions that I identified earlier, that, in fact, it makes it impossible for States then to be able to set those rates, and in fact, sort of pushes the Federal Government into a position, not in this particular legislation, but at some point down the road, where we would be inclined to preempt the States in that regard, because of their inability to control the situation?

Ms. SEGER. Well, the States can still, certainly, legislate usury ceilings, and the point is, I believe, that when you have the *Marquette* decision, and a couple of States are very aggressive in deregulation, this puts a lot of discipline on those other States to

either eliminate their ceilings or to deregulate or introduce floating ceilings rather than fixed. So there's been a great deal of ferment in this whole State usury situation, since the early 1980's. So it's been a competitive situation.

Senator DODD. Let me move on to a couple of other questions and I may come back to that one with you. There is an article called the "Economic Effects of Proposed Ceilings on Credit Card Interest Rates." I am sure you are familiar with this.

Ms. SEGER. Yes.

Senator DODD. It is prepared by a number of people at the Board's Division of Research and Statistics, and I will ask unanimous consent that it be included as part of the record.

The authors of that particular report, and I quote them, say that, "Credit card profits clearly benefited from the drop in funding costs in recent years." That is a quote from the report. They also cite other reasons in the report that conclude, and again I quote, "It seems doubtful," the report says, "that the increase in profitability reflects diminished competition in the credit card industry, yet the rates of return, as we know, for 1984 and 1985, are way above the historic levels that we have seen for credit card loans and are greater than any other loan returns for most institutions."

My question simply is, quite obvious. If the industry is truly competitive, shouldn't consumers see the benefits of that competition within that timeframe?

Ms. SEGER. Well, let me comment first on the profitability issue. If you look at the whole string of annual data from 1972 through 1985, I think you find that the average for that whole period is something like 1.9 percent. There were years in the early 1980's during which time banks actually lost money on their credit card operations. Then when market rates started down in late 1982 and fell still more in 1984 and 1985 this definitely did help the profitability. But as I said, over a longer period of time, the profitability has not been above 3 percent, it has been closer to 2 percent.

Again, if you look at what is going on out in the marketplace, I think that you do see that individual institutions have cut their offering rates, not everybody. One example that is usually trotted out for a major issuer that does not cut rates is Citibank in New York, and they are at 19.8 percent, I believe. They were last I checked. But then there are other New York banks that have reduced their rates—I think Manufacturers Hanover, for example, cut its rate from 19.8 percent to 17.8 percent. Someone mentioned earlier, the American Express case, where they are offering a new card at 13.5 percent, and Sears has come in with a Discovery card.

I mean, it seems to me that there are numerous alternatives available to individuals.

Senator DODD. Well, I will come back to that one, as well, in terms recouping old losses, in terms of profitability and in terms of current competitive factors.

Let me turn to Senator Gramm, and we are going to try and stay in the 5-minute rule, if we can, here.

Senator GRAMM. Well, Ms. Seger, let me thank you for your testimony.

What you are saying in response to the questions of our distinguished chairman, if I hear you correctly is, in essence, you see a

lot of evidence that market forces are at work in the credit card market.

If I may, let me have the now-famous "Shelby chart." [Laughter.]

Senator DODD. Which has been accepted, by the way, as a——

Senator SHELBY. Can I offer that in evidence as my No. 1 exhibit?

Senator DODD. We are going to have this as a Shelby exhibit No. 1. It is a piece of uncontroveted evidence here, that has now been accepted as fact. [Laughter.]

Ms. SEGER. Does he have it copyrighted?

Senator DODD. We do.

Ms. SEGER. Oh, you do. I see.

Senator GRAMM. Now whether he's being paid royalties or not, we haven't ascertained.

If you notice, the blue line here is credit card rates, and in 1981, the prime rate was above the credit card rate, so I think it is fair to say that loans being made through credit cards were losing money.

Ms. SEGER. They were in Michigan.

Senator GRAMM. Why would banks want to issue credit cards and lose money?

BANKS AND CREDIT CARD LOSSES

Ms. SEGER. Well, I can just speak for one State. I happen to have been a regulator in 1981 and 1982 in Michigan, and there the banks had credit card programs on the books, and all of a sudden, a shop I am now associated with started to tighten monetary policy and interests rates and the market rose dramatically, and the usury ceiling in Michigan on credit cards was 18 percent. And all of a sudden, the banks were having to fund those outstandings with short-term money costing them 18, 19, 20 percent, and so, again, they certainly were losing on a marginal basis.

Senator GRAMM. You might say in this period, of course, prime was high and if banks could attract customers by providing credit card services that, in essence, they were a loss leader in this period.

Ms. SEGER. Well, maybe so banks used them as a loss leader. I think it was a more a fact that they were in them, and they couldn't get out graciously. I do know of banks that made it very difficult to get new customers on board. You know, if you already had a card issued to you, banks didn't take the cards away, unless you did something like going over your credit limit or not paying on time, things like that. But I know that there was a great reluctance on the part of banks to add credit card customers.

Senator GRAMM. So you would say, in fact, that during this period in 1981, whether it was loss leader, whether it was being trapped by usury limits, whether it was being in business with an inability to adjust, that that rate of return—or that interest rate on credit cards in 1981, in the long run, was probably unsustainable?

Ms. SEGER. That would be my opinion, yes.

Senator GRAMM. Now you know, or I would assume you believe that the credit industry is one of the more competitive industries in the country. In fact, we have worldwide credit market. So potentially, millions of competitors, and yet in the face of a market that

is worldwide, extremely competitive, and where entry and exit are very easy—I mean, all the characteristics of an almost near perfect market selling a homogeneous product. And yet now we are out here in 1987 and credit card interest rates are way up here. Personal loan rates have not come down very much either, and prime rates are down here and T bills and discounts. Why?

No obviously, you've got to speculate, but why do you think that is the case?

Ms. SEGER. Well, I guess I would make two points. First of all that credit card interest rate line on the chart represents an average, and averages are not necessarily the kind of statistic that is designed to give all the information about what is going on. But beyond that, what we know is that if you are a financial institution, and you are making loans of any type, the revenue that you earn from that loan has to cover all your costs. I mean, not just the funding cost, which is what we are basically talking about when we indicate that market rates have come down. The funding costs of credit cards have clearly dropped, but there are other costs that lenders have to cover.

One very big one is administrative costs, such as processing the accounts every month, getting the bills out. That sort of thing. As the fundings costs have come down, in many cases the costs due to bad debts have zoomed, and there are credit card issuers that are writing off 4 or 5 percent of their outstandings. And again, that is a cost of being in this business. And so I think that we have to pay more attention to all of the costs combined, rather than just the funding cost, which is a significant cost. I am not denying that, but they have to cover all of them.

Senator GRAMM. A final question, since I am out of time and the red light's on here.

Ms. SEGER. OK.

Senator GRAMM. Do you or has the Federal Reserve Bank in its extensive analysis found any evidence of any collusion in restraint of trade or traditional price fixing in the sale of credit card credit in this country?

Ms. SEGER. I don't think we have specifically investigated it, but I am not aware of any of it going on myself. Now, I heard Congressman Schumer indicate that he had asked Attorney General Meese to check on the VISA thing, but I——

Senator GRAMM. Well, this was a letter, to whether this letter represents an attempt to collude in restraint of trade, and I think that is a legitimate question.

Senator DODD. Before getting to my colleague from Alabama, I think it is worthwhile to point out on this chart in the 1981 period, the differences between credit card rates and the discount rate, 6-month T bill rate, the prime rate, and the personal loan rate. There is a lot of parity in there. They go back and forth together. Nothing that remotely reflects the disparity that exists now. That is the point of it, I think, that is creating this situation. The tremendous disparity.

You can understand fluctuations of 1 point or 2. We are talking here maybe 1 point or 2, in some cases of difference on that chart, but now we are talking as much, in some cases, as a 15 or 16 point difference. That will drive you a little crazy. Senator Shelby.

Senator SHELBY. Mr. Chairman. Ms. Seger, as a member of the Board of Governors of the Federal Reserve, I welcome you here.

Ms. SEGER. Thank you.

Senator SHELBY. I do want to get back on the chart. I have passed it around. I won't charge any interest on it today from my friend, the Senator from Tennessee or the chairman or the Senator from Texas, but this chart says a lot, if you look at it. And I know it's a graph, but notwithstanding the cost of money—you know, money is a commodity, is it not, in the marketplace.

Ms. SEGER. Yes, sir.

Senator SHELBY. In 1981, the prime, and you can trace the prime in green, all the way up, it was off the chart nearly. At the same time, look at where your credit cards were. This is the point that the chairman has been making. It is the point I have been talking about, I believe we all. But there is certainly a big gap between now the prime, which is in this area and the credit card rate which has remained almost constant, if not gone higher.

Is that a given?

According to the chart, of which the source of the stats, is the Federal Reserve Board.

Ms. SEGER. Well, as I suggested earlier, the Fed collects statistics from lenders, and that is an average credit card rate.

Senator SHELBY. That is the point.

Now we know that there is administrative costs in administering any business, whether it be one, a credit card operation out of a department store, whether it be out a large bank, small bank, you name it. But you've got to point out that this doesn't make any sense, does it? There is such a gap. Except a large sense of profit there maybe.

Ms. SEGER. Well, I——

Senator SHELBY. I would like to have your comments, as a member of the Board.

Senator DODD. Let me add to it, if you would.

Senator SHELBY. Yes.

Senator DODD. On the functional cost analysis report in 1984 net earnings before losses in credit cards is 13.149 percent. Net credit losses are 1.6 percent of that, with a net earnings of 11 percent and net earnings after the cost of money of almost 4 percent in credit cards. Now that is pretty good. The suggestion earlier you made that the net credit losses are somehow part of the justification of keeping rates up would not be borne out by these statistics.

Ms. SEGER. Well, I don't want to get on my lecture on our imperfect functional cost analysis data. One of my crusades is for us to either get that improved or drop the project.

Senator DODD. Are these bad numbers?

Ms. SEGER. They are imperfect numbers. It is based on a very small sample of reporters. It is not the same group each year. There are various problems with those numbers. But I won't get off on that.

Senator DODD. I am sorry, I didn't mean to ——

Senator SHELBY. Governor Seger, those might be bad numbers, but these graphs explicitly show the basic rates. Would you give this to—would you acknowledge that?

Ms. SEGER. As I indicated, market rates have definitely come down from their highs in the early 1980's.

Senator SHELBY. Sure. If these stats, and they do come from the Federal Reserve Board statistics, and they are basically right, as far as you know, as a member of the Federal Reserve Board?

Ms. SEGER. What we are collecting is, I hope, accurate; yes, sir.

MOST PROFITABLE BANK OPERATION

Senator SHELBY. What is the most profitable part of a bank operation today? Is it not, in fact, credit card operation in a lot of banks, where they have a certain part of the market, and so forth?

Ms. SEGER. I think probably that is true for some banks.

Senator SHELBY. That is what I mean. It is true for a lot of banks that the most profitable part of the bank—and we're certainly not against profits, but we are certainly against gouging—would be the credit card operations?

Ms. SEGER. I think that is probably true.

Senator SHELBY. If there is a certain spread in anything between what money costs you and what you can loan it out for, it is certainly shown here; is it not?

Ms. SEGER. Well, I don't see any item on there that would be the cost of funds for a bank, but if you have——

Senator SHELBY. Prime rate. I mean——

Ms. SEGER. That's not the bank's cost.

Senator SHELBY [continuing]. It's not the cost. I know that. But at the same time, it would be indicative of the cost of money; would it not?

Ms. SEGER. Well, their cost of funds would be better measured by something like the CD rates, you know, the liability side of the balance sheet.

Senator SHELBY. But all of this is factored in to these prime rates; is it not? The cost of what you are paying for your deposits or the cost of what you borrow on short term from the Fed, and everything. All of this is a factor on the part of the equation.

Ms. SEGER. It is one of the things that the management looks at to make the prime rate decision; yes, sir.

Senator SHELBY. But I think the chart just shows some things that haven't been answered here today.

Thank you, Governor.

Senator DODD. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

Ms. Seger, as I understood you a moment ago, you indicated that you would not favor overriding the *Marquette* decision, which allows a bank to move across a State line and to then export their interest rate into a State that has a lower rate of interest; is that correct? You would not favor overriding the *Marquette* decision?

Ms. SEGER. Well, I think I said that we, at the Board, had not specifically discussed this, so I am reluctant to say what our official position would be without discussing it, but I said my personal view would be not to override it.

Senator SASSER. Well, if we don't override—if we don't pass any credit card cap legislation, and if we don't override the *Marquette* decision, then what would occur in my native State of Tennessee,

where the legislature is presently contemplating legislation to put a cap on interest rates? If they put a cap on interest rates, then the banks issuing the credit cards, if they so choose, could simply move across the State lines into Mississippi, just pull Mississippi out of the hat there, and export into Tennessee or mail back into my native State of Tennessee, the same credit card and exceed the statutory interest rate provisions that had been enacted by the Tennessee State Legislature.

That is correct; isn't it?

Ms. SEGER. I am not familiar with the Mississippi law, but they could move into South Dakota or Delaware, I know that——

Senator SASSER. Right.

Ms. SEGER [continuing]. And export from there; yes, sir.

Senator SASSER. Then it is true—if we don't pass a cap, and if we don't know something to override the *Marquette* decision, that the banks would be free, theoretically, to charge whatever the traffic would bear on interest rates?

Ms. SEGER. Well, as I indicated, I think you are seeing rates come down in selective cases. It has been very sticky. The lags have been long, but I think you are seeing more and more competition.

Senator SASSER. I guess my point is this. You have indicated that the Federal Reserve has historically stated that it ought to be a question reserved to the States to set interest rates, but we are doing violence to that principle, if we allow the *Marquette* decision to stand. The States will not be able to regulate interest rates within their borders applicable to bank credit cards, because bank credit cards will flow across State lines. You will see banks shutting down their credit card operations in States where there is a cap on the rates and moving to States where there is no cap.

So if we hold to the view that States ought to be sovereign over the interest rates, then it follows, to my mind, that we would have to pass legislation to overrule the *Marquette* case.

FED BELIEVES INTEREST RATES SHOULD BE SET BY STATES

Now you also said that the Fed historically believes that interest rates ought to be set by the States. Well then, why does the Federal Reserve Board approve applications from bank holding companies to set up out-of-State credit card banks and then permit these banks to export their high interest rates into States which have ceilings on credit card rates?

What I am saying is, I don't think the Federal Reserve ought to be able to have it both ways. I don't think you ought to be able to say interest rates are a matter that we think, historically, ought to be reserved to the States. And then, on the other hand, charter or approve applications for bank holding companies to set up out-of-State credit card banks, whose sole purpose is to circumvent the interest rate ceilings that have been set by the States themselves.

I mean, we ought to have some consistency here. Either the States can regulate interest rates and regulate bank cards in their borders or they can't. I mean, that is my point. The Fed ought to be consistent about this.

Don't you see an inconsistency in this whole proposition?

cally do not make late payments. Also, convenience users are less likely to exceed established credit limits because, again by definition, they ordinarily do not carry a balance forward from one billing period to the next. Therefore, an increase in the prevalence of such fees or in their average amount resulting from more stringent rate ceilings would have a greater effect on borrowers.

In addition to the price increases previously described, banks might institute or raise fees for cash advances on credit cards. Banks and retailers might establish or increase fees for processing credit card applications, replacing lost cards, providing additional cards for an account, and issuing monthly statements. Retailers might start charging separately for services that had been provided without charge, such as gift wrapping, delivery, and alterations. Pricing these services seems likely to affect users of bank cards as well as of retail cards and convenience users as well as borrowers.

Unpredictability of Adjustments

For several reasons, adjustments in credit card availability and pricing that would follow the imposition of a restrictive nationwide rate ceiling cannot be foreseen with precision. Card issuers would be likely to adopt different policies depending on how they expected their customers to respond, and additional shifts would occur once those reactions became clear.

Adjustments in pricing and credit availability would be subject to important constraints, including competition from other credit card issuers as well as regulations that limit pricing changes in some states. A few credit card issuers already have adapted to fairly stringent rate ceilings at the state level, and might have little additional adjustment to make. Issuers that operate under less restrictive state ceilings would likely face greater pressures to make changes in credit availability and pricing.

Evidence of the Effects of Credit Card Rate Restrictions on Consumers

The preceding discussion described the potential responses of card issuers to restrictive rate ceilings and the possible consequences of such actions for consumers. Several studies conducted during the past two decades have addressed these issues empirically, investigating creditor responses to differing interest rate restrictions at the state level and evaluating the effects of such reactions on consumers. These research results provide valuable historical evidence that suggests some likely consequences of a national credit card rate ceiling.

Effects on Credit Availability

One major conclusion of the empirical studies is that restrictive rate ceilings for consumer credit are closely associated with tighter lending standards. Most studies have concluded that higher rate ceilings are associated with lower rates of consumer loan rejection or with a larger percentage of loan defaults.[8] These findings suggest that lenders extend credit to a broader range of credit applicants when the rate of interest allowed on their consumer loan portfolios is higher. Therefore, creditors are likely to apply more accommodative credit standards when the price of credit is determined by market forces, and to use stiffer loan criteria when regulations hold rates below market-determined levels. As noted, not all consumers are affected equally by lower interest rate ceilings. Given the criteria that credit card issuers usually employ for determining creditworthiness, lower-income families and families headed by younger persons would seem to be among those most likely to be denied credit as a result of such ceilings.[9]

Effects on Availability of Bank Credit Cards

A 1979 study by researchers at the Credit Research Center (CRC) at Purdue University is particularly useful for examining the effects on consumers of placing legal restrictions on credit card rates. The CRC study surveyed consumers and creditors in four states with different interest rate ceilings.[10] One portion of the study focused on consumer use of credit cards, including the effects of rate ceilings. Three states—Illinois,

Louisiana, and Wisconsin—had relatively high credit card rate ceilings; the fourth, Arkansas, had an unusually low rate limit.

The CRC study found that the proportion of consumers holding bank credit cards was substantially smaller in Arkansas than in the three states with less restrictive interest rate ceilings. Only 29 percent of the families in Arkansas held bank credit cards (table 5). By contrast, 39 percent of families in the other three states held such cards. These results suggest that more restrictive rate ceilings were associated with more limited availability of bank credit card accounts.

Although this broad perspective on the effects of controls on credit card rates is helpful, it does not show whether specific consumer groups are more likely than others to be affected by a national ceiling on credit card rates. To examine this issue more closely, bank credit card holding was compared according to family income, age of family head, and education for residents of Arkansas and of the three other states (table 5). In most categories, a significantly smaller proportion of families held bank credit cards in Arkansas than in states with less restrictive credit card rate ceilings.

Further analysis of the CRC survey data using multivariate procedures suggests four main conclusions:[11] (1) In all four states, the probability that a family held a bank credit card rose as family income, age, and education of the family head increased. (2) Lower- and lower-middle income families in Arkansas, the state with the most restrictive rate ceiling, were less likely to hold bank cards than were equally endowed families in the other states. (3) Higher-income families in Arkansas were as likely to hold bank credit cards as were higher-income families in states with less restrictive rate ceilings. (4) Overall, families residing in Arkansas were significantly less likely to hold bank credit cards than were families living in one of the three states with less restrictive rate ceilings. In sum, these findings suggest that tight ceilings on credit card interest rates are more likely to result in reduced availability of bank credit card accounts for lower- and lower-middle income families than for higher-income families.

Furthermore, a study of the credit card market in New York State supported the CRC evidence about the likely effects of credit card rate ceilings on bank credit card availability.[12] As previously discussed, increases in the minimum acceptable point score needed to qualify for credit cards are one way that card issuers might respond to the imposition of more restrictive rate ceilings for credit cards. In the New York study, the credit scoring system of a large bank credit card issuer and actual data for credit card account holders were used to determine the percentage of credit card applicants that would be rejected if credit standards were tightened.

Table 6 shows the result of successive five-point increases in the minimum qualifying credit score. Raising the minimum score from 19 points to 24 points would have prevented about 2 percent of the bank card holders from obtaining the credit cards they held. If the minimum qualifying

5. Proportion of families with selected characteristics that hold bank and retail credit cards in Arkansas and three other states, 1979[1]

Percent

Family characteristic	Holds bank credit card		Holds retail credit card	
	Arkansas	Other states	Arkansas	Other states
Family income (dollars)[2]				
Less than 6,000	5	10	24	29
6,000–8,999	16	17	48	38
9,000–12,499	24	22	53	43
12,500–17,499	26	36	69	55
17,500–19,999	61	49	79	64
20,000–24,999	35	52	83	74
25,000–29,999	53	57	78	88
30,000 or more	64	68	80	83
Age of head				
Less than 25	19	19	38	35
25–34	39	45	60	63
35–44	57	53	79	70
45–54	40	47	71	68
55–64	30	42	67	59
65–74	21	28	53	46
75 or more	17	15	48	34
Education of head				
0–8 grades	9	14	39	34
9–11 grades	14	26	38	47
High school diploma	33	39	63	60
Some college	34	52	68	66
College degree	51	73	80	82
All families	29	38	61	58

1. The survey covered 3,572 persons. The four states in the study and the number of respondents in each were Arkansas, 787; Wisconsin, 1,006; Illinois, 1,030; and Louisiana, 749. All surveys were conducted in person between January 6 and June 12, 1979.

2. For calendar year 1978. The median income of U.S. families in 1978 was $15,000.

Source. William C. Dunkelberg and others, "CRC 1979 Consumer Financial Survey," Monograph 22 (Purdue University, Krannert Graduate School of Management, Credit Research Center, 1981).

6. Bank credit card holders rejected after simulated increases in the minimum acceptable credit score, by selected scores and income levels[1]

Percent

Increase in the minimum acceptable credit score[2]	All card holders	Income of rejected card holders (dollars)[3]				
		All income levels	Below $7,500	Below $10,000	Below $15,000	Below $20,000
To 24	2	100	89	100	100	100
To 29	7	100	90	98	92	89
To 34	18	100	30	55	77	91
To 39	36	100	19	42	66	87
Memo: Percent of total sample of card holders		100	9	17	42	68

1. Simulation uses the credit-scoring model of a large bank card issuer and the characteristics of the actual holders of the issuer's credit card.
2. Minimum acceptable credit score initially set at 19 points.
3. Income is for 1973. The median income of U.S. families in 1973 was $10,500.

Source: Robert P. Shay and William C. Dunkelberg, "Retail Store Credit Card Use in New York," Studies in Consumer Credit 4 (Columbia University, Graduate School of Business, 1975), p. 55.

credit score were raised further to 29 points, then the proportion of card holders that would have failed to qualify for credit cards would have increased from 2 percent to about 7 percent.

As expected, the effect of credit rationing, as simulated in this example, differs according to income level. Eighty-nine percent of those rejected when the cutoff is set at 24 points have incomes below $7,500, although that income group accounts for only 9 percent of the card holders. No rejected applicant earned more than $15,000 (that is, as table 6 shows, 100 percent had incomes below that level). At the 39-point cutoff, 13 percent of rejected applicants earned $20,000 or more. But even though the raising of the minimum acceptable score adversely affects some higher-income card holders, lower-income card holders still bear the brunt of the decrease in credit availability. When the minimum acceptable score is raised to 24 points, 16 percent of those with incomes under $7,500 are rejected, but only 2 percent of those under $20,000 (not shown in the table). At a score of 39, the comparable proportions of rejections are 77 percent and 46 percent.

Effects on Availability of Retail Store Credit Cards and on Product Prices

If, as indicated, a federally mandated credit card rate ceiling is likely to result in reduced access to bank credit card accounts, what alternative credit sources would be available to consumers? Analysis of the data collected in the CRC study suggests that consumers in a constrained market substitute sales credit, such as retail store cards, for cash credit, such as bank credit cards.

The CRC study provides information on holdings of retail store cards as well as bank credit cards in states with widely differing rate restrictions (table 5). Three-fifths of all families held retail store cards in Arkansas, slightly higher than the share that held such cards in the three states with less restrictive interest rate ceilings. In contrast, as already discussed, the fraction of Arkansas families that held bank credit cards was significantly smaller than the share of families with such cards living in the other states.

These findings are consistent with the expected effects of rate ceilings. Retailers in Arkansas seem to have been able to maintain credit availability by compensating for lower finance charge revenue with increases in some merchandise prices according to comparisons of prices in Arkansas with those in surrounding states where rate ceilings were higher.[13] Major appliances were found to cost about 3 to 8 percent more in Arkansas—nearly 5 percent more on average—than in neighboring states.

Further evidence that product prices might rise if a federally mandated ceiling on credit card rates were adopted is contained in the CRC study. Bank credit card issuers in Arkansas were found to charge retailers merchant discount fees higher than those charged in the states with less restrictive rate ceilings. As with other costs, retailers would be expected to offset these higher fees by increasing product prices. One consequence is that, by paying higher retail prices, consumers who do not use credit cards might subsidize the cost of providing credit card services. Because lower-income families, who have limited access to credit, are heavily represented in the group that purchases products exclusively by using cash, a national credit card rate ceiling might impinge more on this group of consumers than on others.[14]

Indeed, under nationwide rate ceilings there might be greater scope for use of merchant discount fees by banks to offset decreases in revenues due to binding rate limitations. Historically, competition for merchant business by banks that operated from states with high rate ceilings, or with none, probably placed some restraint on the ability of banks that operated from states with low rate ceilings to raise merchant discount fees. However, imposition of a nationwide rate ceiling probably would diminish this type of competition. Banks operating from states with relatively high rate limits might, under a lower nationwide ceiling, raise merchant discount fees to offset any reduction in revenues. In the absence of other significant differences, all banks would then be under equal pressure to rely on higher merchant discount fees as a revenue source. If such fees increased, retailers would be likely to compensate by raising some prices.

Conclusions

Under current patterns of credit card use, about 32 percent of all families incur credit card finance charges and would benefit initially from a federally mandated reduction in credit card interest rates. However, the record of credit card profitability since 1972 suggests that tight rate ceilings such as those proposed in recent legislation would create intense pressures for cost reductions and revenue increases, actions that seem likely to erode some of the benefits to borrowers and impose costs on other consumers.

Several possible responses by issuers to restrictive rate regulations can be foreseen, but it is difficult to predict which ones would be pursued. In an effort to cut expenses, card issuers could tighten credit standards for new credit card applicants—an action that would especially affect lower-income families, who typically have limited access to other sources of credit. Studies have documented the occurrence of credit rationing in response to tight rate regulation for credit cards and more generally for other kinds of consumer credit. Card issuers could also increase nonrate prices for credit card services in order to offset reduced finance charges. Some of these actions—such as initiating or increasing annual fees, charges for each transaction, and levying fees for particular services to account holders—would impose costs on all credit card users. The effects of other repricing measures, such as curtailing the grace period, would be concentrated among convenience users, many of whom could no longer avoid paying finance charges. Still other changes in credit card pricing would fall mainly on borrowers. Such actions include charging penalty fees for late payments and for exceeding credit limits.

Finally, some adverse consequences of a nationwide ceiling on credit card rates could be felt even by those consumers who do not use credit cards. Retailers might increase some merchandise prices—either to help offset reduced finance charge revenue on retailer credit card plans or as a result of higher merchant discount fees. Research evidence indicates that restrictive ceilings on rates are associated with significantly higher retail prices for some types of merchandise. Higher retail prices could mean that customers who usually pay in cash—including lower-income families who cannot obtain credit cards—would subsidize buyers who use credit card services. □

FOOTNOTES

1. "Functional Cost Analysis: 1985 Average Banks," Based on Data Furnished by Participating Banks in Twelve Federal Reserve Districts (Federal Reserve Bank of New York, n.d.) and the same document for each of the years 1972–84.

2. Retailers presumably would not continue to offer credit cards unless the profits from additional merchandise sales facilitated by credit card plans offset the losses on credit card operations alone. National Retail Merchants Association, "Economic Characteristics of Department Store Credit" (1969), p. 53; National Retail Merchants Association, "Economic Characteristics of Retail Store Credit" (1986), p. 21; Robert P. Shay and William C. Dunkelberg, "Retail Store Credit Card Use in New York," Studies in Consumer Credit 4 (Columbia University, Graduate School of Business, 1975), pp. 72–80.

3. The estimates were derived by assuming that lenders would have continued to provide, and that credit card users would have continued to use, exactly the same dollar amounts of credit card services even though the lower rate ceilings were in effect. If forced to operate under more restrictive rate ceilings, bank credit card issuers undoubtedly would take steps to boost revenues and cut costs. But the purpose of these estimates is to show how much the rate regulations would reduce profits, in the absence of any other changes, in order to gauge the pressures on issuers of bank credit cards to make offsetting adjustments.

4. In 1985 approximately 79 percent of commercial banks responding to a survey allowed a grace period averaging approximately 27 days. See American Bankers Association, *1986 Retail Bank Credit Report*, table 120, p. 96.

5. American Bankers Association, *1986 Retail Bank Credit Report*, table 107, p. 89.

6. Ibid., table 112, p. 92.

7. Ibid.

8. Douglas F. Greer, "Rate Ceilings and Loan Turndowns," *Journal of Finance*, vol. 30 (December 1975), pp. 1376–83. Also, consumer survey data indicate that in a state with a low interest rate ceiling (Arkansas), a higher proportion of consumers reported being rejected for consumer credit compared with consumers residing in states with less restrictive rate ceilings. See Richard Peterson and Gregory Falls, "Impact of a Ten Percent Usury Ceiling: Empirical Evidence," Working Paper 40 (Purdue University, Krannert Graduate School of Management, Credit Research Center, 1981).

Robert P. Shay, "Factors Affecting Price, Volume and Credit Risk in the Consumer Finance Industry," *Journal of Finance*, vol. 25 (May 1970), pp. 503–15; Management Analysis Center, "A Study of Bank Credit Card Profitability for Banks Operating in the States of California and Washington" (Palo Alto, Calif., June 1, 1977), p. 73.

9. William C. Dunkelberg, "An Analysis of the Impact of Rate Regulation in the Consumer Credit Industry," in *National Commission on Consumer Finance: Technical Studies*, vol. 6, (Government Printing Office, 1973), pp. 17–20.

10. William C. Dunkelberg and others, "CRC 1979 Consumer Financial Survey," Monograph 22 (Purdue University, Krannert Graduate School of Management, Credit Research Center, 1981).

11. Glenn B. Canner and James T. Fergus, *The Effects of Proposed Credit Card Interest Rate Ceilings on Consumers and Creditors*, Staff Studies (Board of Governors of the Federal Reserve System), forthcoming.

12. Shay and Dunkelberg, "Retail Store Credit Card Use in New York," pp. 55–56.

13. The products most likely to be affected are those that usually are purchased with credit cards—large durable goods especially. See Gene C. Lynch, "Consumer Credit at Ten Percent Simple: The Arkansas Case" (University of Arkansas, College of Business, 1969).

14. Of the families with incomes below $5,000 in 1982, 84 percent had no outstanding installment debt when interviewed in 1983. In contrast, only 53 percent of the families with incomes above $50,000 had no installment debt. Robert B. Avery and others, "Survey of Consumer Finances, 1983: A Second Report," FEDERAL RESERVE BULLETIN, vol. 70 (December 1984), table 4, p. 860.

Ms. SEGER. Maybe our position has not been quite clearly stated. We are not in favor of ceilings on credit card interest rates, period. But if there are going to be some, then we think it is the prerogative of a State to set them rather than for the Federal Government to have, you know, a——

Senator SASSER. I follow you that far.

Ms. SEGER. OK.

Senator SASSER. But then why does the Fed then come along and approve applications for out-of-State credit card operations, so that a bank can move outside of the State of its operation, set up its credit card operation in another State, and then export back into the regulating State, the higher interest that that State's legislature attempted to legislate out of existence? That is the basic inconsistency here in the Federal Reserve's position. And it looks to me like the Fed is going to have to—ought to choose one of the two. Either the States can regulate their interest rates, and the Fed will not approve these applications for out-of-State credit card operations, or just simply the Fed will operate to circumvent the States in regulating their own rates.

Ms. SEGER. I am not a lawyer, but as I understand the Bank Holding Company Act, which is what we are talking about here, it does not give us a legal basis for refusing to grant these applications that come in from various banking holding companies to establish a credit card subsidiary any place. I mean, South Dakota or Delaware or——

Senator SASSER. I understand that, but you are begging the question there, Ms. Seger, because if Congress overrules the *Marquette* case, then that takes care of the problem. A State would be sovereign over its own interest rates with regard to credit card operations, but as I understand your response to the question, from our distinguished chairman, you were saying you don't think *Marquette* ought to be overruled. So it looks to me like you are espousing the Federal Reserve's position here, you are just simply saying, well, we are just going to take a laissez faire view here. We don't think there ought to be any regulation at all on rates for credit cards, either by the States or at the Federal level.

Well, my time has expired.

Senator DODD. We have a distinguished visitor here, our colleague from Nebraska. While not a member of the committee he is going to have some constituents coming along in a bit here. Unfortunately, we haven't gotten to them yet, Senator Exon, but we are delighted to have you here, and I understand you may have a question for the Governor.

Senator EXON. Mr. Chairman, thank you very much. I came here to try and speed things along, but as typical of a U.S. Senator when he hears something, he can't stay out of the fray.

I just have one question for you, Ms. Seger. Traditionally, in days past, when the country wasn't as sure as it is now that competition sets and makes everything equal, it was quite commonplace for the States to have usury rates. In my State of Nebraska, where I served as Governor, we had a usury rate of 9 percent at one time. And I recognize that when things change and when interest rates skyrocketed as they did, primarily by action of the Fed, those laws became obsolete and most of them were repealed.

If I listen to you this morning, what you are saying is that there is nothing wrong with the States, in your opinion, setting usury rates, if they so desire, but you don't think the Fed should do it. Is that your bottom line?

Ms. SEGER. Yes. I will repeat. I said I think that our preference is to have no ceilings, but if there are going to be ceilings imposed, then the individual States should legislate for their individual situations.

Senator EXON. I would remind you, of course, that the situation today is a far cry from what it was in the days of yesteryear when money moved within States without directions from the Federal Government. I am not sure that I am for the Federal Government getting into explicit rate setting or usury rates. I mean, I see some problems with that. On the other hand, when we federalize more than ever before our monetary policy with the Fed, it seems to me that sets up a mechanism, right or wrong, that has some obligations to make sure that large international and national financial schemes and pockets of money in money center banks, particularly in the East, do not, under the guise of the free enterprise system, set interest rates much higher than is nominal or reasonable. I saw the chart a few minutes ago with regard to interest rates, especially regarding credit cards. Despite what you think, I think it is outlandish. I think it is way out of line. I think somebody is taking advantage of someone.

I am simply telling you that it is not reasonable to expect Congress to sit idly by, despite what most of us would like to see as a free enterprise system, if we believe that the free enterprise system is not working. Large money center banks and money controllers, or to use an older phrase, money changers, may be taking advantage of certain parts of our citizenry that, right or wrong, are making use of credit cards in their daily lives.

Thank you, Mr. Chairman.

OPPOSE CAP APPROACH

Senator DODD. Well, thank you very much, Senator Exon, and I think it underscores the point, not to our present witness, but to others who will be coming afterward, that the disclosure approach is one that I think makes the most sense, but I sense sometimes that there are those on the outside who believe that this is sort of the extreme position, and there is not much constituency here for a cap approach. I think the cap approach is wrong. I will state that flat out. I don't want to get to that at all. I think it is chaotic. It would create a mess. I think the consumer is ill-served by it. But I can tell what is going to happen. It is not beyond the realm of possibility that you could end up passing cap legislation in both the House and the Senate, and so I hope that the issuers appreciate what we are trying to do with this approach, and that they will take it for what it is and the position of the Fed as well.

You just can't explain to people the disparity in the numbers. It just is not understandable, when they see a prime rate or discount rate, and then see a credit card rate. Now you can razzle and dazzle all you want, but the fact of the matter is, the average consumer doesn't understand it. They are the ones who are going to be

up here banging on the Congress to do something about it. Federal preemption may be the way they want us to move. I hope they don't. I hope we can deal with it more effectively, but as the Senator from Nebraska just pointed out, that seems to be the trend.

I just have a couple of quick questions for you, if I may. They are more housekeeping matters. But again, this article that I have referred to, and I will include it in the record—and I thank, by the way, my colleague from Nebraska for being here and for his observations as well. The article that I showed you earlier, Ms. Seger, suggests one implication of a national limit—and again, the cap on card rates might be what they call a curtailment of credit card enhancement. They identify one of those enhancements as the protection programs that indemnify credit card holders for charges made with lost or stolen credit cards, which is, again, a quote from them.

I wonder if you might tell us what the utility of that particular enhancement is, in light of the $50 limit on credit card loss and the statements by issuers that no one has ever been charged the $50 fee. At least I can't find an issuer that has ever charged the $50 fee, when someone has had a lost or stolen card. What is the efficacy of that enhancement?

Ms. SEGER. Well, maybe this is a semantic thing. I think the author was probably suggesting that that cost—that $50 a card—is being eaten, and that that is a cost that the issuer is having to cover along with all the other costs, when the cards are lost.

Senator DODD. You made reference in the last part of your testimony that with regards to the request from the Central States, and this goes to the witnesses who will be coming from the Senator from Nebraska's home State, that you rejected their request on the grounds that,

> The policyholder's contract rights under State law provide adequate protection and that such requirement is an unnecessary burden on bank holding companies, not required under the proper incident standard of section 4(c)(8) of the Act.

I wonder if you would comment on this proposal from the standpoint of the consumer, and second, would it make sense to require notice and re-enrollment, when the new insurance adversely affects the rights and benefits of the consumer.

Ms. SEGER. Again, most States, I believe—and this is a tradition that Congress has honored—do regulate in the insurance area, including credit life insurance, and that is where the primary regulation comes from. Also in this credit life matter and the suggestion for notifying customers when the bank holding company changes its underwriters—again, I am not a lawyer, but the legal people helped me on this—suggested that if I, let's say, had borrowed money to buy a car, and I got credit life insurance and then the bank changed from provider A to provider B, that my contract rights would be defended, even though, you know, the specific insurance company had changed.

Now, you know, if that is not the case, then I would certainly like to be corrected.

Senator DODD. Well, are you—and again, maybe this is the kind of question that you could go back to your people with and ask. I am not trying to put you on the spot here with it, but we are sort of caught in that Catch-22 situation again. The bank holding com-

pany acts as a creature of Federal legislation. We have gone through this argument on the powers issue, as you know, over and over again, particularly when it comes to the insurance activities, and the like. And I understand it from the standpoint that you have responded to, at the State level, that has been the venue of regulation; however, when you start getting consumer impact under the aegis of the Bank Holding Company Act, I think legitimate questions are raised from a consumer standpoint with regard to notice an reenrollment.

I would like to have you readdress that question, if you could, and respond to that one.

[Governor Seger subsequently submitted the following:]

The evidence presented to the Board does not demonstrate that the consumer will be significantly disadvantaged by a change in underwriters so as to justify the burdens on consumers of reenrollment. Such a requirement could mean the loss of insurance coverage for consumers who fail to respond to a reenrollment notice, for example. In addition, requiring reenrollment would impose substantial administrative burdens on bank holding companies, thus making it economically difficult for holding companies to change insurers. It is questionable whether such results are in the consumer's best interest. In fact, I believe that they are not. The only certain beneficiaries of the reenrollment proposal are Central States Insurance Company and other underwriters that have contracts with bank holding companies and will be protected from competition.

In evaluating the proposals pertaining to changing underwriters last year, the Board was presented only with limited evidence of marginal policy changes resulting from a bank holding company selecting a new underwriter. The type of changes in the insurance policy mentioned included, for example, a change in the waiting period for benefits from 30 days to 31 days, and a two-year suicide exclusion. There was no suggestion that the amount of coverage or the premium paid for the coverage would be altered when insurance underwriters were charged.

Given the small amounts of coverage and small premium amounts involved with the insurance policies written on credit card amounts, it is unlikely that policyholders choose to purchase insurance on the basis of waiting periods or suicide exclusion provisions. Without some evidence of consumer problems that are not currently being addressed by State law or the consumer's contract rights, I believe that it would be inappropriate to impose additional requirements on bank holding companies. Even if one were to conclude that consumers should be informed of marginal changes in their insurance coverage, I do not think consumers would benefit from a reenrollment requirement.

MORE TIME FOR FED TO DEVELOP RULES FOR CARD ISSUERS

Senator DODD. Last, your testimony calls for some longer times for the Fed to develop rules for card issuers to comply with them. I wonder if you could give us any indication of what you are looking about in time.

Ms. SEGER. I think what we had in mind was that if we're going to have some new disclosure requirements come out for annual fees, grace periods, et cetera, we should give the individual issuers 6–7 months, something like that, to get forms printed.

Senator DODD. You are talking about a relatively brief period of time.

Ms. SEGER. Yes.

Senator DODD. I don't know if you heard my suggestion with regard to the grace period but some of the issuers are concerned about disclosure of grace periods because they vary. Do you have any difficulty with defining a period of, say, 25 days, as a grace period?

Would you like to think about that one and get back to us?

Ms. SEGER. Yes, I will think about that. I know, I personally have two credit cards. One has a grace period and one doesn't. And the one that does have the grace period has a higher rate, higher APR than the one that starts the meter running immediately. So I do think you have to look at the two together——

Senator DODD. Yes, I agree.

Ms. SEGER [continuing]. To be fair. Yes.

[Governor Segar subsequently submitted the following:]

Ideally, a plan's grace period disclosure would indicate the specific number of days during which no finance charge would be imposed if the billed amount is paid in full by the consumer. It is my understanding that several credit card issuers have proposed that the required grace period disclosure be limited to whether or not a credit card plan offers a grace period. I agree with your conclusion that simply disclosing that a plan does or does not have a grace period would be of limited value to consumers, since grace periods vary in length. In fact, such a disclosure requirement could confuse or mislead consumers since card issuers with relatively short grace periods would, based on their grace period disclosure in an advertisement or solicitation, appear to the consumer to be as favorable as card issuers with longer grace periods.

Your proposal to avoid such problems by defining what constitutes a grace period, for example, 25 days, would provide a meaningful disclosure to consumers while allowing credit card issuers to disclose only the existence, or the lack, of a grace period. However, there are several potential drawbacks or difficulties with establishing a defined, standard grace period that must be considered. For example, credit card issuers that have a grace period that is longer than the standard number of days may very well shorten the grace period. This would operate to decrease the "free ride" currently offered to consumers. In addition, we are not sure what the appropriate number of days should be for the defined grace period—should the time period be 21 days, 25 days, or what? If the time period chosen is not the one most commonly used by card issuers, card issuers that wanted to continue to offer a grace period and be able to advertise that fact might be required to incur significant costs to adjust their systems. For example, if the defined grace period were 25 days from the statement closing date, card issuers with grace periods of 21 days would either have to change their systems so that they offered a 25-day grace period or state in advertisements and solicitations that they do not offer a grace period.

These questions, and others, need to be examined closely to determine whether the potential problems and costs of developing a simple "yes" or "no" disclosure for grace periods, by defining a grace period, exceed the benefits of such an approach. On balance, requiring a simple disclosure of an issuer's practice with respect to the offering of a grace period—including the number of days—may be the best approach.

Senator DODD. But I think there is some difference in what constitutes a grace period. There are apparently issuers who believe that they would like to be able to use a shorter grace period than others, and I understand that, but I think we ought to for the purposes of the bill define then what a grace period is.

Ms. SEGER. I see. So you are not talking about defining it as much as you are talking about setting a minimum number of days that would qualify——

Senator DODD. That's it. Definitely. Defining it would be the minimum number of days.

Ms. SEGER. OK.

Senator DODD. Yes.

Ms. SEGER. I guess I am not sure what that proper number of days ought to be.

Senator DODD. I am not requiring that they have one. Just if you do have one, there would be a standard by which we can all determine what a grace period constitutes—a minimum.

Ms. SEGER. But I am just saying that I don't know if the standard ought to be 21 days or 25 or 30.

Senator DODD. Well, we might look at that. We are going to look for some guidance from the Fed on that, as well as support.

Ms. SEGER. We can certainly examine that.

Senator EXON. May I make one comment?

Senator DODD. Absolutely.

Senator EXON. I take it, Ms. Seger, that you feel that the Fed has little, if any, responsibility with regard to consumer protection. Is that a fair conclusion to draw from your testimony? I mean, you've had your say about how you feel the usury rates should not be a part of the national set up. Now you have indicated, with regard to credit life insurance, that the bank should have unlimited authority, without even notification to the borrower of the change in life insurance. I am not saying that your position is necessarily incorrect, although I think it might be, but I guess you are saying that the Fed should bother itself only with monetary policy and not with consumer protection.

Ms. SEGER. Oh, boy, if you have drawn that conclusion, I have really misled you, because we do an awful lot with consumer affairs. The whole truth-in-lending area has many, many facets that we enforce. We have compliance examiners who are going, you know, into the various financial institutions that we regulate. We are seeing to it that the Equal Credit Opportunity Act is enforced, the Truth-in-Lending—I mean, the whole long list of legislation that the Congress has passed and that we have been given the responsibility for administering, et cetera, and I think we take this very seriously.

As I said, I am in favor of disclosure, perhaps I said this before you arrived. I am not sure. But I am all in favor of giving the consumer every bit—as much information as we can to help the consumer make an intelligent decision and protect himself.

As I said on this matter of the change in the insurance carrier, I am told by my legal staff that the individual rules are established by the States. I can't tell you, frankly, if that is true or false, because I am not a lawyer, but I have been told that, as a result of the State laws, consumers rights are protected.

Senator EXON. Well, I am not a lawyer either, Ms. Seger. But my experience has been that, if you can get one lawyer to tell you one thing, you can get another lawyer to tell you exactly the opposite. They both claim that they are forthright and honest. It is a differnce of opinion.

Senator DODD. There you go again. Your tax lawyer——

Senator EXON. We have to watch that a little bit. Thank you very much. [Laughter.]

Ms. SEGER. I just can't challenge either one of them, because I don't know.

Senator DODD. Do you have any further questions, Senator Sasser.

Senator SASSER. No, Mr. Chairman. Thank you.

Senator DODD. Well, we thank you very much for being here this morning. It has been very helpful. And as I said earlier, the Fed has been tremendously supportive, and we want to work very closely with the Fed, as we complete our drafting of this particular bill.

Obviously, your input, and involvement is extremely important to us, and if you could, at a convenient time, respond to those last couple of questions, I would appreciate it very much.

Ms. SEGER. We will do that and any other assistance that you would like to request, we will deliver on.

Senator DODD. I thank you.

I am going deviate a bit for 1 second. We have a witness who has a flight connection problem. Just to give you a sense of what we are going to do, we are going to hear from this witness and then go to the panel, the second panel on the list, and then we are going to take a break before getting to panel 3, because we are running a little longer than we had anticipated.

I am going to ask Walter Connolly, who is chairman of the Bank of New England Corp. in Boston, to take the witness stand, if he would, and ask Meredith Fernstrom, James Weisler, and Alan Silberstein to forgive me for a few minutes, because Mr. Connolly, I am told, is faced with a rough scheduling problem. And I apologize—and I should add, he is a constituent, and he votes, among other things. I am not suggesting the other three don't. I just don't know where the hell you live. [Laughter.]

And if I find out you all live in Connecticut, I have just made a huge error, politically. [Laughter.]

Which may be the case. But at any rate, we thank you for being here. Mr. Connolly, Walter Connolly, I should tell my colleagues on the committee is a—we are very proud of the fact he comes from Connecticut. He has been tremendously creative in the banking field, has taken our Connecticut Bank & Trust Co., a very sound and successful institution in the State of Connecticut, and has merged and is now with the Bank in Boston, one of the most successful financial institutions in the country, and has been a very good friend, personal friend, has given me a lot of advice. Unfortunately, I don't follow it all the time, as he will be sure to point out in his testimony here this morning, but we thank you for being here this morning, and we will be glad to receive your testimony.

Senator DODD. Mr. Connolly.

STATEMENT OF WALTER CONNOLLY, CHAIRMAN, BANK OF NEW ENGLAND CORP., BOSTON, MA

Mr. CONNOLLY. Thank you very much, Senator. I appreciate being here with you and other members of the committee. I would have to add, Senator, that you have unfailingly been a good listener, and I really appreciate the opportunity to express my views today.

As you indicated, I am chairman of the Bank of New England Corp., which is a company of approximately $27 billion in asset size and 18,000 employees in Connecticut, Massachusetts, Maine, and Rhode Island. Our company was formed in June 1985, when the Supreme Court ruled in favor of allowing us to compete what was then the first regional interstate bank merger.

And I am particularly happy, and I think it is particularly significant that I be here to testify this morning, because it was Senator Douglas, the author of the Douglas amendment, that enabled us to form our company, who was also the initiator of the Truth-in-Lend-

ing Act which, of course, is what we are talking about here today, is a derivation of the disclosure in Truth-in-Lending.

More than 100 million people in the country now use some form of credit card, and I have heard it said that those people don't pay much attention to credit card interest rates or that, in effect, they pay attention to everything else, but they don't pay attention to credit card interest rates.

Our experience is just the opposite from that, Mr. Chairman. We think that customers do pay attention to interest rates. When we advertise and disclose interest rates which are lower than those available in the market, we do business, and when our rates get much above what is available in the market, our competitors are quick to point out to the general public that that is the case and we don't do as much business.

So we are in favor—we are in favor of S. 616, which we think is a step in the right direction and one that is very carefully and very well-crafted.

Currently, there are about 14,000 banks in the country. About six of those banks issue one-quarter of the bank credit cards, so that a national marketplace is rapidly evolving. The practice in the industry has been to have disclosure after the issuance of the card. We think they should have the benefit of that information when they are making the decision to apply for a credit card, not only in writing, but if the solicitation is made over the telephone, we think there should be clear disclosure of the fact of what the terms and conditions are in that period.

We also think that the cost of a credit card, the interest rate is only one factor, the annual fee, the grace period and the method of interest computation are all a part of the price of this type of credit, and we think that that should be disclosed simply and succinctly along with the interest rate.

In New England, we operate on a highly competitive market, and our credit card interest rates are among the lowest in the country. I am free to admit that there is a certain amount of self-interest in my espousal of this, Mr. Chairman, because we believe that our lower interest rates have enabled us to increase market share of credit card holders in our area, particularly in areas that are contiguous to the boundaries of New England where some banks are charging higher interest rates. We, in effect, are paying off their customers' card balances with our lower rates every day, and we like to advertise those rates, and we think that full disclosure will just enable us to continue to increase market share.

We think that the proposal requiring disclosure is far preferable to ceilings or caps. Our experience with interest rate ceilings is that they are always too high or too low and that if the market operates, effectively and properly, the free market will bring rates into line.

I would just vary a little bit and say that I can't really rationalize the gap in Senator Shelby's chart. I may have some ideas as to why it was there, but I suspect that as Representative Schumer indicated, with the attention that you are drawing to this issue, my guess is that spread is going to narrow. The market is going to make that spread narrow, regardless of whether or not there is a cap.

I would be pleased to provide any information that might be useful, in addition, Mr. Chairman. You have a copy of my full testimony. This is really a summary of it, in the interests of time. I realize your committee is pressed for time.

Thank you.

[Complete prepared statement of Mr. Connolly follows:]

TESTIMONY OF

WALTER J. CONNOLLY, JR. CHAIRMAN

BANK OF NEW ENGLAND CORPORATION

BEFORE THE

SUBCOMMITTEE ON CONSUMER AFFAIRS

OF THE SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS

MARCH 26, 1987

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

I APPRECIATE THIS OPPORTUNITY TO APPEAR BEFORE YOU THIS MORNING. MY NAME IS WALTER J. CONNOLLY, JR. I AM CHAIRMAN OF BANK OF NEW ENGLAND CORPORATION. WE ARE A REGIONAL BANK HOLDING COMPANY WITH 480 BANKING OFFICES AND 18,000 EMPLOYEES IN CONNECTICUT, MASSACHUSETTS, MAINE, AND RHODE ISLAND. OUR HEADQUARTERS ARE IN BOSTON. WE HAVE ASSETS OF $27 BILLION AND ARE AMONG THE 20 LARGEST BANKING ORGANIZATIONS IN THE COUNTRY.

OUR COMPANY WAS FORMED IN JUNE OF 1985, WHEN THE SUPREME COURT RULED IN OUR FAVOR AND ALLOWED US TO COMPLETE THE FIRST REGIONAL INTERSTATE BANK MERGER. THE COURT BASED ITS DECISION ON THE DOUGLAS AMENDMENT TO THE BANK HOLDING COMPANY ACT OF 1956, AN AMENDMENT OFFERED ON THE FLOOR BY SENATOR PAUL DOUGLAS OF ILLINOIS AS THE MEASURE WAS BEING DEBATED IN THE SENATE.

I AM PARTICULARLY HAPPY TO BE ABLE TO OFFER MY COMMENTS ON S. 616, SENATOR DOUGLAS WAS NOT ONLY THE AUTHOR OF THE LEGISLATION THAT MADE OUR COMPANY POSSIBLE. HE WAS, OF COURSE, ALSO THE FATHER OF TRUTH-IN-LENDING, WHICH YOUR BILL, MR. CHAIRMAN, REFINES AND ADAPTS TO CONDITIONS WHICH HAVE EVOLVED SINCE THE ORIGINAL LEGISLATION WAS FIRST ENACTED ALMOST TWENTY YEARS AGO.

More than 100 million people in this country now use some form of credit card. Forty percent of the population have at least one bank card. The issue we are considering, detailed and uniform disclosure of credit card interest rates and fees, will affect millions of consumers and billions of consumer dollars.

I have heard it said that people don't pay much attention to credit card interest rates, or, in other words, that the same consumers who carefully compare prices in supermarkets and at airline ticket offices don't really care about the cost of their credit cards. Well, that's not our experience.

Our experience has been that lower rates are meaningful to consumers. In a well advertised campaign, our Connecticut bank, The Connecticut Bank and Trust Company, lowered rates and gained thousands of new customers. Competitors responded with their own lower rates, and consumers across the state benefited.

Mr. Chairman, we do not believe that people don't care whether they are charged 21%, 19% or 17%. We think they do care, and that, with clear disclosure statements made to them at the time of solicitation, they will compare, make informed decisions, and benefit from the competitive market that will result.

Currently, there are approximately 14,000 banks in the United States, but six of them already issue one-quarter of the bank credit cards in circulation. A national marketplace is

rapidly evolving. New York institutions send their credit cards to consumers on the Pacific Coast, and California banks have a significant share of the business in the Midwest.

The practice in the industry has been to provide disclosure <u>after</u> the card has been applied for and approved - this is when the customer receives it in the mail. We think consumers should have the benefit of that information before that - when they are making the decision to apply for a credit card.

Interest rate is not the only measure of a card's cost. The cost also depends on other terms, such as the annual fee, grace period, and the method of interest computation. If these, along with the interest rate, are disclosed in clear language at the time of solicitation, the consumer will have a fair basis of comparison.

New England Banks operate in a highly competitive market, and their credit card interest rates are among the lowest in the country. We support this disclosure proposal because it will benefit consumers, but I freely admit that we also support it because we believe it will benefit us by increasing market share for our banks and other New England banking institutions. The six out-of-area banks that control 25% of the national credit card market all have a strong presence in New England, despite the fact that their interest rates are four to nine percent higher than those of local banks. We think they would have less

Senator DODD. Well, we appreciate that, and obviously, your testimony will be made a part of the record.

Let me just tell you how refreshing it is to have someone come and be an advocate and a supporter of what we are trying to do here, not the sort of begrudging support that we get, over sort of facing a political outcome, rather than understanding what we are trying to do here. And I think your last comment particularly, is one that I subscribe to totally and wholly, and that is, that if you have disclosure, clear disclosure, consumers—give consumers a little credit, as someone once said, for being able to make choices, by and large, that if we do that, and let the market work, I've got to believe this will result in those rates coming into line, whatever that line should be. They may be up. They may be down. And there may be, as someone pointed out, disparity.

As you say, there are credit risks, and frankly, banks are not going to, and they shouldn't be risking other investors' money, if you will, by extending credit to people who may not be able to carry a credit card, for whatever reason.

So I would prefer, as you have testified in the very forthright piece of testimony, a disclosure approach.

I wonder if you might, for the purposes of the record, give us an indication of what your company charges at present and how that compares with the majors and whether or not you are making a profit at it. Maybe you would like to answer the last question first.

MAKING A PROFIT AT CURRENT RATE

Mr. CONNOLLY. Our average rate, because we have slightly different rates. There are variations of something on the order of one-half of 1 percent between States, but our average rate, I would guess, is about 15¼ percent, and we are making money at that rate. The profitability of credit cards is a function of three things. It is cost of money, operating costs, and losses. We add them all up and come to the conclusion that we can make a profit at the 15-percent rate.

Senator DODD. Senator Sasser.

Senator SASSER. Thank you very much, Mr. Chairman.

Mr. Connolly, what percent of the cost of operating your credit card operation is comprised by the cost of the money itself, as opposed to administrative costs, et cetera?

Mr. CONNOLLY. I would have to give an approximation, Senator, because I don't have the exact figures. We could provide to the committee.

Senator SASSER. Just a ballpark figure would be fine.

Mr. CONNOLLY. Just off the top of my head, I would say somewhere around 6½ is cost of money. Let's say 7 percent, cost of money, 5-percent operations and 2-percent losses, which is about 14 percent.

Now that varies for each issuer. The object of our management is to lower the cost of money, become the low-cost producer, and there are a lot of administrative costs, because there are so many transactions with these relatively small accounts. We lower the administrative costs and control the losses. Fourteen may be a little high. I

think we are lower than that, actually, when I add them all up. But those are relative orders of magnitude.

Senator SASSER. I am just trying to get a handle on this myself, if I understand you correctly then, in your actual cost of 14½ percent or whatever it is, the cost of the money itself would be what, 50 or 60 percent of the total cost component?

Mr. CONNOLLY. The cost of the money is the one thing we have least control over, because we are subject to market rate. I believe our blended cost of money now at the Bank of New England is somewhere around 6 percent, maybe plus or minus a few basis points.

Senator SASSER. Well, what I am trying to get at is, what would be the percent of your overall cost, the money component itself?

Mr. CONNOLLY. It would vary with the level of interest rates. If the interest rates were at 18, as they were 5 years ago, the cost of money would be two-thirds of the cost. Right now it is about 40 percent, I guess.

Senator SASSER. About 40 percent. So——

Senator DODD. That is about the national average, too, I believe.

Senator SASSER. Right. So when the prime was high a few years ago, you said your money costs would be about 66 percent of the total cost, and now it would be about 40 percent.

Mr. CONNOLLY. Again, in that order of magnitude, Senator. I don't have the numbers in front of me.

Senator SASSER. I am just trying to nail down, for my own purposes—you are one of the few witnesses in the business I have encountered, who will lay out what the costs are, and I am simply trying to ascertain for my own purposes, how much of the money cost is overall—so we can be fair when we make these statements: well, the prime has dropped from 21 down to 8 percent, and then you are still keeping your bank card interest rates at 18½ percent, why hasn't it come down?

Mr. CONNOLLY. The cost of operation declines as the rates come down.

Senator SASSER. Excuse me?

Mr. CONNOLLY. Excuse me. The cost of money declines as a percentage of the total rates come down and goes up as rates go up.

Senator SASSER. Right.

Mr. CONNOLLY. Because the fixed cost are fixed.

Senator SASSER. But I want to be sure that we are understanding each other, and I am not trying to be tricky here with you.

Mr. CONNOLLY. No, no. I understand.

Senator SASSER. As I understood you a moment ago, when rates were high, you indicated that the money component of your overall cost would have been 66 percent of the 100 percent of overall cost. As the rates have come down, the money cost of your overall operation has been reduced from 66 percent down to roughly 40 percent.

Did I understand you correct?

Mr. CONNOLLY. That is correct. Yes.

Senator SASSER. So as the rates have come down then, just using rough figures, the overall cost of credit card operation has probably been reduced about 26 percent, because your money cost has come down from 66 percent of your overall cost to about 40 percent.

Mr. CONNOLLY. No question, the overall cost has been reduced.

Senator SASSER. Right. I am asking these questions, because I want to get a realistic idea of what a reasonable rate would be, which would give the banks a reasonable profit, which they are certainly entitled to, and what a reasonable cap might be, if ultimately, the Congress chose to go to a cap.

CREDIT STANDARDS

Let me ask you this, Mr. Connolly, do you screen your credit card applicants more carefully than other banks in your region that might be charging higher rates, or do you know?

Mr. CONNOLLY. I don't know that we screen any more or less carefully, or that we have any more or less strict credit standards. I am not privy to anybody else's standards. As a matter of policy, we don't mail cards outside of our service area, so that we generally tend to know more about—tend to know a lot about the people we issue cards to.

Senator SASSER. Do you think your administrative costs are lower than your competitors or comparable with theirs?

Mr. CONNOLLY. Again, we don't compare costs, and the costs I gave you are only approximate. I would say we probably are a relatively low cost producers, but my guess would be that we aren't as low a cost producer as the larger issuer

Senator SASSER. As the larger issuers are?

Mr. CONNOLLY. That would be my guess, because there are economies of scale. I can't give you any order of magnitude.

Senator SASSER. There is one other question I wanted to ask you, and it escapes me at the moment. Maybe I will think of it in a moment, Mr. Chairman. If I do, could I reserve the right to ask that final question?

Senator DODD. Absolutely.

Senator SASSER. Thank you.

Senator DODD. We won't deprive you of that at all.

Senator Exon, do you have any questions?

Senator EXON. I have no questions, Mr. Chairman. Thank you.

Senator DODD. Well, maybe we will just reserve that and submit it in writing, unless you would like to come back to it.

Senator SASSER. I hate to exhibit publicly how absentminded I am becoming, Mr. Chairman, but I honestly can't remember that question, which seemed very important about 5 minutes ago.

Senator DODD. Well, regarding one thing that the Senator from Tennessee raised, in terms of talking to you about the prime at 18 and the cost of money as it affects the cost of issuing credit cards as being roughly 66 percent, the prime coming down as 40 percent. The difference we are not talking about is 26 percent in that case but rather the percent—40 percent of 60 percent, which is a different number, in terms of that calculation, it seemed to me. So it is a bit different. It would be smaller actually than what the 26 percent would be.

Mr. CONNOLLY. I am a little uncomfortable being too precise about these numbers because I don't have anything in front of me, Senator, I am doing it in my head.

Senator DODD. But what is important is clearly—the percent of the cost of money is clearly far less with the prime being what it is and what it was, in terms of credit cards. That much is certain. We know that.

Mr. CONNOLLY. Or as the Senator indicated in a another way, the overall cost is lower.

Senator DODD. Correct.

Mr. CONNOLLY. Yes.

Senator DODD. That you can say. I think it is dangerous percentages of what——

Mr. CONNOLLY. Yes.

Senator DODD [continuing]. Differences that means.

Senator SASSER. Mr. Chairman, I have thought of the question.

Senator DODD. I knew if I talked. I knew if I kept talking, you would. [Laughter.]

LESS CREDIT AVAILABILITY AT LOWER RATES

Senator SASSER. Mr. Connolly, what do you—what is your reaction to the statements that are made that if we lower rates on bank cards that this will have the effect of denying credit to a substantial number or denying access of the cards to a substantial number of people? Has that been your experience as you have lowered your rates below those of your competitors?

Mr. CONNOLLY. Well, since credit or since charge-offs are part of the three elements of cost in the business, if we found our margins were being squeezed to a point where it was approaching unprofitability, among things that we would do would be that we would probably become more selective in the way in which we granted credit; yes. My guess would be that our rejection rate would rise.

Senator SASSER. But at the present time you don't think that you screen your credit card applicants any more minutely than those of your competitors in your region?

Mr. CONNOLLY. I really can't respond. I don't know whether we do or not, Senator.

Senator SASSER. All right.

Well, Mr. Connolly, I thank you very much for your answers. They have been very illuminating.

Senator DODD. One other thing, Walter, before you run off. Senator Sasser raised with our Governor from the Fed the important question that is before us as well, while it is not a part of this bill, having to do with the *Marquette* decision. Now obviously, doing business in Connecticut, the State legislature in our home State went through the process last year, I think it was, of setting a cap in the State, and obviously the witnesses will testify that, while that affects Connecticut institutions, it doesn't affect those doing business outside of the State that issue cards in the State.

Do you have a position on the *Marquette* decision regarding whether or not we ought to try and preempt?

Mr. CONNOLLY. As you know, Senator, and as your colleagues may know, we have an interest rate cap in Connecticut on credit cards, and the oil companies have to comply with the Connecticut statute, and the retail companies have to comply, and I don't see any reason why any out-of-State issuers shouldn't have to comply.

Senator DODD. So you would prefer to see this, even though you are a regional banker now. You are doing banking in a number of States, obviously, throughout the New England area, but you would prefer to see us legally overturn, if you would, by statute, the *Marquette* decision?

Mr. CONNOLLY. Well, I certainly wouldn't be opposed to it. I don't know that I would advocate it. We have no intention of moving, so it has no relevance to us. [Laughter.]

Senator DODD. Well, thank you very much. I like the idea that you are not afraid of good competition with some of those big New York center banks that we have talked about in the past, and that disclosure might, in fact——

Mr. CONNOLLY. Well, we have got to be careful, Senator.

Senator DODD. But we have allowed the regional banking to go forward.

Senator SASSER. One final question.

Senator DODD. We're keeping you here.

Senator SASSER. Where do you write to make application for one of your bank credit cards?

Mr. CONNOLLY. We will be glad to send you an application, Senator.

Senator SASSER. All right. I would like to have one.

Mr. CONNOLLY. Thank you very much, and we will make sure that you get one.

Senator DODD. I want to thank you very much for being here.

Our second panel of witnesses, and I apologize to them for holding up to allow Walter Connolly to go forward.

Meredith Fernstrom, who is a senior vice president in charge of public responsibility for American Express, James Wiesler, vice chairman of the Bank of America, representing VISA, and Alan Silberstein, who is the senior vice president, Chemical Bank of New York, representing MasterCard.

We welcome all three of you to the committee. If I have mispronounced—is it "Weisler," did I pronounce it?

Mr. WIESLER. Wiesler.

Senator DODD. Wiesler. I apologize.

And Mr. Silberstein, is that correct?

Mr. SILBERSTEIN. That's fine.

Senator DODD. Fine. We thank all three of you for being here this morning. The same rules apply. I know you have testimony. It will be, of course, a part of the record. We would appreciate a synopsis of that, the key points you would like to make or however you would like to proceed, but if you can keep it down to 5 or 6 minutes apiece, or so, that will give us a chance to get to the questions, which I think may be more helpful to all three of you as well. And we thank you for being here, and we hope that some of the testimony you heard earlier will give you a chance to respond to some of the questions that have been raised.

Why don't we begin with you, Ms. Fernstrom?

STATEMENT OF MEREDITH FERNSTROM, SENIOR VICE PRESIDENT, AMERICAN EXPRESS

Ms. FERNSTROM. Good morning. Thank you, Mr. Chairman. My name is Meredith Fernstrom, and I am senior vice president for public responsibility at American Express Company.

I welcome the opportunity to address your committee regarding the charge card disclosure proposals that are before you. American Express has long been regarded as a leader in our commitment to the consumer. Because of that firm commitment, we strongly support the efforts of the subcommittee to require full and fair disclosures in open-end credit applications. We favor the approach taken in S. 616, the Full Credit Card Cost Disclosure Act, which you introduced, Senator Dodd, and which is cosponsored by Senator Proxmire.

INFORMED CONSUMERS

We believe that consumers are able to make an informed choice between competing credit products, only if they fully understand the terms before, and not after, they apply for a credit product. Informed consumer choice is the best guarantee that competition in the marketplace will be fair, vigorous, and responsive to consumer needs. The subcommittee is to be commended for its efforts to assure that consumers have the information necessary to make those choices.

As has been mentioned already this morning, American Express will, for the first time, begin to offer credit cards to our card members. This product, which we call the Optima card permits a card member to defer repayment of charges over time and is, therefore, a true credit card. It may interest you to know that disclosures similar to those in S. 616, will be provided on all of our Optima card applications issued throughout the United States. S. 616 recognizes the difference between a credit card and a charge card and it provides separate disclosures for each. The bill not only allows consumers to compare different credit cards, but it will also allow them to distinguish between charge cards and credit cards. We consider this a vital distinction, since holders of credit cards can defer payment of the balance, whereas holders of charge cards must pay the balance in full each month. We recognize that this is often confusing, even sometimes to the most informed consumers, such as the distinguished Senator from Texas, who apparently did not recognize the distinction between credit cards and charge cards.

If consumers fail to understand this crucial distinction, they may be faced with paying a bill in full, which they thought they could pay over time. Our basic card products, the American Express Card, the Gold Card and the Platinum Card are charge cards which must be paid in full upon receipt of the monthly statement.

We support the provision of the bill that requires us to disclose this "pay in full" feature up front. In order that the disclosures contemplated by S. 616 are provided to all consumers throughout the country, we have recommended some amendments to S. 616 which were supplied to your staff earlier. We also urge that you adopt a Federal standard for credit and charge card disclosures. Recently, several States have enacted charge applications laws, and

while they are substantially similar to S. 616, each of these laws imposes slightly different requirements.

For example, a recent California law is almost identical to S. 616, and it specifically requires charge card disclosures.

On the other hand, Virginia and Wisconsin passed legislation which does not include separate treatment for charge cards. Legislation requiring application disclosures is being actively considered in a number of States, including New York, Texas, New Jersey, Minnesota, Oregon, Illinois, Hawaii, and North Carolina. Virtually all of the existing State laws and pending bills are substantially similar to S. 616, yet each one requires disclosure of the same information in a slightly different manner and each applies to different types of applications and solicitations. Some apply to all applications and some only apply to applications which are mailed to a consumer.

As a result, it seems appropriate and reasonable to impose a uniform national standard for credit and charge card application disclosures. Thus, any card issuer or creditor complying with Federal law should be deemed to be in compliance with similar State law. More importantly, consumers would receive standardized information allowing for easy comparison of the relative cost of this popular form of credit.

In conclusion, I would like to reiterate our strong support for S. 616 and also to commend the work of your subcommittee in providing vital information to consumers before they actually apply for a credit or charge card. We would be pleased to work with your staff to further address any of the issues that I have raised, and I would also be pleased to answer any questions you might have.

[Complete prepared statement of Ms. Fernstrom follows:]

PRESENCE IN OR MARKETPLACE IF CREDIT CARD CUSTOMERS WERE MORE AWARE OF THE DIFFERENCES IN RATES. REQUIRING DISCLOSURE OF TERMS AT THE TIME OF SOLICITATION WILL CLEARLY BENEFIT CONSUMERS, BUT IT COULD ALSO MEAN MORE BUSINESS FOR US AND OTHER NEW ENGLAND BANKS.

WE BELIEVE THAT THIS PROPOSAL, REQUIRING DISCLOSURE OF TERMS AT THE TIME OF SOLICITATION, IS FAR PREFERABLE TO PROPOSALS FOR INTEREST RATE CEILINGS OR "CAPS". THE EXPERIENCE WITH RATE CEILINGS IS THAT THEY ARE USUALLY HIGHER THAN THEY NEED TO BE, OR LOWER THAN REQUIRED BY MARKET FORCES. WHEN THEY ARE HIGHER, THEY TEND TO BECOME THE PREVAILING RATE. WHEN THEY ARE LOWER, THEY RESTRICT THE VOLUME OF CREDIT. A "CAP" WOULD TEND TO RESTRICT THE USE OF CREDIT CARDS TO THE MORE AFFLUENT MEMBERS OF SOCIETY, WHILE DEPRIVING MANY AVERAGE CONSUMERS OF A TREMENDOUSLY USEFUL AND FLEXIBLE FINANCIAL TOOL AND FORCING THEM TO RESORT TO MORE RIGID AND POSSIBLE MORE EXPENSIVE FORMS OF CONSUMER CREDIT.

JUSTICE HOLMES ONCE SAID THAT "THE BEST TEST OF TRUTH IS THE POWER OF A THOUGHT TO GET ITSELF ACCEPTED IN THE COMPETITION OF THE MARKET". I AM CONFIDENT THAT CREDIT CARE TRUTH-IN-LENDING, WITH FULL DISCLOSURE AT THE TIME OF SOLICITATION, IS A PRINCIPLE THAT WILL FIND ACCEPTANCE IN THE COMPETITION OF THE MARKET, AND PUT THE POWER OF RATE DETERMINATION WHERE IT BELONGS, IN THE HANDS OF THE CONSUMER.

MR. CHAIRMAN, I WOULD BE PLEASED TO PROVIDE ANY INFORMATION THAT MAY BE USEFUL IN THE COMMITTEE'S DELIBERATIONS. IF THERE ARE ANY QUESTIONS NOW, I WOULD BE HAPPY TO TRY AND ANSWER THEM. THANK YOU FOR YOUR ATTENTION AND FOR THE OPPORTUNITY TO PRESENT THE PERSPECTIVE OF BANK OF NEW ENGLAND CORPORATION TO YOU THIS MORNING.

STATEMENT OF

EDWIN M. COOPERMAN
PRESIDENT - CONSUMER CARD GROUP, U.S.A.
AMERICAN EXPRESS TRAVEL RELATED
SERVICES COMPANY, INC.

Testimony before the
U.S. Senate Committee on Banking,
Housing and Urban Affairs
Subcommittee on Financial Institutions
and Consumer Affairs

March 26, 1987

STATEMENT OF AMERICAN EXPRESS

Mr. Chairman, members of the subcommittee, good morning. My name is Edwin M. Cooperman. I am President - Consumer Card Group, U.S.A., American Express Travel Related Services Company, Inc. ("American Express"). I welcome this opportunity to address the Subcommittee regarding the charge card disclosure proposal before you.

American Express has long been regarded as a leader in our commitment to the consumer. We have a variety of policies and programs which are designed to assist our customers and the general public in exercising their consumer rights and making informed choices in the marketplace. For example:

- Our series of consumer brochures called "ConsumerCards" cover topics including women's credit rights, mail order rights, how to buy insurance, and how to avoid credit card fraud. Several of these were drafted in collaboration with the Federal Trade Commission.

  We have distributed almost two million copies of these booklets to the public at no charge.

- We also provided grants to the Consumer Federation of America for the production of two of its recent consumer brochures, "Your Savings Options" and "Your Credit Options," which advise consumers how to shop wisely for savings and credit products.

- Last year, we sponsored a series of seminars conducted in five cities by the Harlem, New York Consumer Education Council, to assist low-income consumers in establishing or re-establishing credit.

- We recently launched a series of seminars on credit and financial planning for U.S. military personnel stationed abroad, in conjunction with the Department of Defense and our affiliate's Military Bank Division.

- American Express has been honored by Consumer Digest magazine for our "excellent consumer education programs and the establishment of a Public Responsibility position to ensure accuracy in advertising."

Because of our strong commitment to the consumer's interest, we support the efforts of the Senate Banking Committee to require full and fair disclosure in open-end credit applications. Nevertheless, we wish to take this opportunity to call your attention to some of the practical problems involved in complying with the credit card application disclosures proposed by pending legislation and to offer suggestions to resolve these problems which we believe will ultimately benefit both creditors and consumers.

American Express® Cards

Except for our recently announced Optima℠ Card, American Express Cards are not credit cards -- they are charge cards. Unlike virtually all bank and most retail credit cards, these Cards do not offer automatic "open-end" credit. Each Cardmember's balance must be paid in full upon receipt of his or her monthly statement. No finance charge is imposed on charges incurred on such Card accounts. If a Cardmember fails to pay in full, collection activity ensues and the account may be cancelled. The Full Credit Card Cost Disclosure Act introduced by Senator Dodd, and co-sponsored by Senator Proxmire recognizes this feature and, as a result, allows for separate treatment of charge cards and credit cards.

We support the Subcommittee's goal of clarifying the terms and pricing of the many credit cards offered to consumers. Through clear disclosures, consumers will be able to make more informed decisions when choosing credit products. In reviewing the language of the proposed Full Credit Card Cost Disclosure

STATEMENT OF JAMES B. WIESLER, SENIOR VICE CHAIRMAN, BANK OF AMERICA, REPRESENTING VISA

Mr. WIESLER. Good morning, Mr. Chairman, Senator Sasser. I am James Wiesler, vice chairman of Bank of America and a member of the board of directors of VISA.

On behalf of VISA and its more than 18,000 members, I want to thank you for this opportunity to appear before you today and testify.

At the very outset, I would like to say that VISA supports disclosure legislation, as long as it provides consumers with useful information and does not impose unnessary burdens on card issuers; however, VISA does strongly oppose any legislation that would artifically limit credit card interest rates.

Let me just first address the interest rate caps. VISA opposes any interest rate caps, because the history has clearly shown that rate caps do stifle competition, and it ultimately limits the availability of credit to those who need it the most, like low income applicants and first-time families and young people graduating from their education areas.

There is competition today that is bringing down the credit card interest rates, and they are falling, falling every day. Over 4,000 VISA banks issue VISA cards alone. Today, for example, VISA member banks, acting independently, offer rates as low as 12 percent, with the average rate overall being about 17.5 percent, and it is clearly falling.

Also, annual fees average only 15 percent and many VISA members charge no annual fee at all. In addition, almost half of all card holders pay no interest on their credit cards, taking advantage instead of interest free grace periods.

Because interest rate ceilings have anticompetitive effects detrimental to lenders and consumers alike, VISA fully supports Senator Dodd's statement, as reported in the American Bankers, that the House of Representatives should abandon its attempt to artificially limit credit card interest rates.

On the other hand, VISA supports legislation to provide consumers with pertinent information for comparison shopping among all charge cards and credit cards.

We urge this subcommittee to adopt legislation that effectively enables consumers to compare the most significant credit terms without imposing unnecessary burdens on card issuers, and VISA believes that any disclosure legislation should apply equally to all charge card issuers and credit card issuers alike.

There is no real difference between a credit card and a nonbank bank card. Both compete directly for credit card accounts and credit card outstanding. There also is no functional differences between a conventional card with a grace period and a travel and entertainment card with a related standby line of credit. VISA believes that consumers should be provided with sufficient information to compare all of these competing card products, and any additional disclosure requirements apply, should also apply equally to all card issuers.

When selecting information to be disclosed, VISA urges this subcommittee to keep in mind the goal of any such disclosure legisla-

Act, however, we are concerned that it may be interpreted in a way which would mislead rather then enlighten consumers on the nature of the American Express Charge Cards.

For example, our Gold Card®, which like our other charge cards requires full payment upon receipt of a monthly statement, also provides a Cardmember with an ancillary independent open-end line of credit offered not by the card issuer, but by one of over 2,000 depository institutions nationwide. As far as we know, our Gold Card program is unique in the charge card industry and presents particular disclosure problems in the context of the bill before the Subcommittee.

The line of credit is an ancillary feature of Card membership, one of several service enhancements to the Gold Card. This line cannot be accessed directly through the Gold Card. It is an option that need never be used and is generally accessible only via checks or drafts drawn on the participating depository institutions. Credit extended under these lines is separately billed to Cardmembers directly by those institutions.

At the time that a consumer applies for a Gold Card, the depository institution, which will become the creditor for the line of credit, is not known by American Express. After an application is received, it is assigned to a depository institution which makes its own credit decision for the line of credit. Depository institutions are assigned according to several factors including the location of the applicant, the applicant's current bank relationships, and the credit criteria required by each institution.

To further complicate matters in terms of the proposed disclosures, each institution sets its own terms for the line of credit, including annual percentage rates, accrual of finance charges, and access to the account. None of these terms are known by us at the preapplication stage.

In accordance with current Truth in Lending Act regulations, these terms are separately disclosed to the Cardmember directly by the depository institution before or at the time the line of credit is made available. As a result, full and complete disclosure of all material terms and conditions are made known to consumers prior to gaining access to such line of credit.

In addition to the ancillary credit offered in connection with the Gold Card, we also offer the Sign & Travel Account to all Cardmembers, which permits them to defer certain prepaid travel packages on a limited basis. This feature is an optional ancillary benefit of Cardmembership, incidental to, but clearly separate from, the main function of the Card.

Consumers should not be deprived of the kind of straightforward disclosure they need to make informed decisions. Mr. Chairman, the mechanical and compliance issues we have raised are not intended to detract from our belief in, or commitment to, complete disclosure of meaningful and comparable data. As a result, we suggest the proposed Full Credit Card Cost Disclosure Act should be amended to more accurately recognize the distinctions between credit cards and charge cards and thus require different and distinct disclosures on their respective applications.

The Optima Card

I believe you may have heard that American Express will, for the first time, begin to offer credit cards to a portion of our existing cardmember base. Unlike existing cards from American Express, these Optima Cards will provide a revolving line of credit and thus permit a cardmember to defer repayment of card charges. Optima Cards offer a 25 day grace period and a variable rate of interest keyed to the prime rate, adjusted semi-annually. In addition, there is a $15 annual fee for issuance of these new cards. This fee will not be imposed on individuals who currently have a Platinum Card.

We fully support the proposed credit card disclosure requirements of the Full Credit Card Disclosure Act and, we have already decided to provide disclosures similar to those required by S. 616 on all of our Optima Card applications.

State Disclosure Requirements

Recently, several states have enacted credit card application disclosure requirements substantially similar to those proposed bythe Full Credit Card Disclosure Act. Unfortunately, these state laws each impose slightly different disclosure requirements. For example, California's Areias-Robbins Credit Card Full Disclosure Act of 1986 requires disclosure of similar information in a manner other than as described in Section 2(a). While the Areias-Robbins Act makes separate provision for charge cards, Virginia, which has recently passed legislation very similar to California, makes no such distinction. On the other hand, Wisconsin passed a law last year which requires disclosure of slightly different information in all applications, including, "applications contained in advertisements."

Many other states are currently considering legislation requiring credit card application disclosures such as New York, Texas, New Jersey, Minnesota and Oregon. Virtually all existing state laws and pending legislative proposals are

substantively similar to the proposed Full Credit Card Cost Disclosure Act. Yet each requires disclosure of the same information in a slightly different manner. As a result, it seems appropriate and reasonable to impose a uniform national standard for credit and charge card application and solicitation disclosures. Thus, any card issuer or creditor complying with federal law should be deemed to be in compliance with similar state law. As a result, consumers would receive standardized disclosure allowing for easy comparison of the relative costs of this most popular form of credit.

We have drafted proposed amendments to the Full Credit Card Cost Disclosure Act which are designed to achieve all these goals. Such tailored disclosures can help educate consumers about the relative costs of credit. These amendments would unquestionably avoid the problems inherent in compliance with a multiplicity of state laws. Our amendments would require separate disclosures for charge card applications to emphasize that the outstanding balance is due and payable upon receipt of the card statement.

We would be pleased to work with appropriate committee staff to further refine these recommended changes.

At this time I would be pleased to answer any questions you may wish to ask.

PROPOSED AMENDMENTS TO
FULL CREDIT CARD COST
DISCLOSURE ACT

1. On page 4, line 1, add "periodic" after "other" and before "fee."

2. On page 4, line 2, (a) delete "or use" and (b) delete the period after "card" and insert ", which shall be expressed as an annualized amount."

3. On page 4, line 5, delete "and in accordance with a periodic" and on page 4, delete line 6; in lieu thereof insert "a periodic statement rendered for such charge card account."

4. On page 4, delete lines 7 through 25 and insert the following in lieu thereof:

"(B) For purposes of subparagraph (A)--

(i) the term 'charge card means a card, plate, or other single credit device that may be used from time to time to obtain credit which is not subject to a finance charge; provided however, that if credit under an open-end consumer credit plan may be obtained in connection with such charge card,

such open-end consumer credit plan is not automatically accessed through use of such charge card; and

(ii) the term 'charge card account' means an account that can be accessed by a charge card."

5. On page 7, delete lines 7 through 14 and insert the following in lieu thereof:

"(e) Notwithstanding the provisions of section 171(a), the provisions of the laws of any State expressly requiring disclosure of terms and conditions concerning credit card accounts or charge card accounts prior to the establishment of such accounts, shall not be applicable to creditors or issuers of such cards who provide applications and make solicitations in compliance with the provisions of this section."

6. On page 7, delete lines 15 through 24 and insert the following in lieu thereof:

"(d) Effective Date -- Except for Section 2(c) which shall become effective upon enactment, the provisions of this Act shall become effective at the end of the 90-day period beginning on the date of enactment of this Act, and shall apply only with respect to applications, solicitations, and other material distributed after the end of such 90-day period."

EXPLANATION

Unlike bank credit cards, the traditional American Express Card does not offer automatic open-end credit. Each Cardmember's balance must be paid in full each month upon receipt of his or her monthly statement.

There are two very limited exceptions to this policy. In response to many requests from our Cardmembers, several years ago we began offering a Sign & Travel Account which allows Cardmembers to charge airline tickets, cruise tickets, and certain travel packages on a limited open-end credited basis. This feature is an optional, ancillary benefit of Card membership which is used by a very small percentage of Cardmembers. There is no separate application for Sign & Travel, since this limited form of credit is one of several service enhancements to Card membership. Complete disclosure of all terms and conditions of this account is given to our Cardmembers when they first receive their Cards, including the 18% interest rate charged on all outstanding balances.

Given the special nature of this Sign & Travel feature, we believe it should be distinguished from other more customary forms of open-end credit and thus not be subject to the disclosure requirement embodied in this bill.

A similar but perhaps more complicated difficulty arises in connection with the Gold Card Line of Credit. This Gold Card program is unique in the charge card industry and presents particular disclosure problems. Like the American Express Card, the Gold Card is a charge card with the Sign & Travel feature. The Gold Card also has a line of credit, but it is not extended by American Express. Instead, it is offered by approximately 2,300 different financial institutions which are not legally affiliated with American Express.

When a consumer sends us a Gold Card application, he or she can be assigned to any one of a number of financial institutions depending on geographic locations, existing bank relationships and other credit criteria required by each institution. As a result, American Express does not know which financial institution will extend the line of credit until after it has received the application. Since each financial institution sets its own terms and conditions for its line of credit (including annual percentage rate, accrual of finance charges, and access to the account.) disclosure of such information for these lines of credit cannot be included in the Gold Card application.

This amendment is, therefore, intended to provide disclosures appropriate for the basic charge card product, while exempting these unique forms of open-end credit from the proposed disclosure.

In addition, a number of States have recently enacted credit card application disclosure requirements which impose slightly different obligations. Several other states are considering similar measures. Thus, it is reasonable and appropriate to establish a uniform national standard for credit and charge card applications and solicitations. As a result, consumers would then receive standardized disclosures allowing for easy comparison of the relative costs of this most popular form of credit.

tion, to provide consumers with information permitting each comparison of competing credit and charge cards, which would increase the likelihood that consumers will actually make the effort to comparison shop.

We believe that the three most significant terms for consumers are the annual percentage fee, the annual fee, and the existence of the interest-free grace period.

With respect to the grace period, VISA recommends that any legislation require card issuers to disclose only the existence or lack of a grace period and only in connection with purchases of goods and services. A lengthy narrative description of the grace period is not appropriate for the early shopping of disclosures.

Again, I would like to thank you for the opportunity to testify here today. We have submitted a full testimony of our views. I would be delighted to answer your questions.

[Complete prepared statement of Mr. Wiesler follows:]

TESTIMONY OF
VISA U.S.A. INC.
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS
OF THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
MARCH 26, 1987

Mr. Chairman, members of the Subcommittee, I am James B. Wiesler, Vice Chairman of Bank of America National Trust and Savings Association and a member of the Board of Directors of VISA U.S.A. Inc. ("VISA").[1] On behalf of VISA, I want to thank the Subcommittee for the chance to testify on proposed legislation requiring credit card applications and solicitations to disclose principal account terms, and establishing a ceiling on the interest rates that may be charged in connection with consumer credit card accounts.

VISA supports disclosure legislation that would provide consumers with meaningful and clearly presented information with certain credit card applications, as long as the legislation does not impose unnecessary operational burdens on credit card issuers. VISA strongly opposes any legislation, however, that would artificially limit interest rates on credit card accounts.

I. SENATE DISCLOSURE PROPOSALS.

This Subcommittee currently has before it three bills which would impose additional disclosure requirements in connection with solicitations and applications for credit card accounts, namely S. 241 introduced by Senator D'Amato of New York, S. 616 introduced by Senator Dodd of Connecticut and S. 647 introduced by Senator Sasser of Tennessee. Although we endorse efforts to enact such disclosure legislation, we believe that all three proposals could require disclosure of excessive information at the application stage, thus hindering, rather than fostering, intelligent comparison shopping by consumers. Moreover, the scope and complexity of the required disclosures would place a substantial operational burden on card issuers. Instead, we believe that legislation like that introduced in the House of Representatives by Congressman Doug Barnard of Georgia (H.R. 1086) would most effectively provide the most significant terms to consumers, without imposing unnecessary burdens on card issuers.

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1 VISA is a membership association comprised of financial institutions in the United States which are licensed to use the VISA service marks in connection with payment systems, including credit cards.

Specifically, S. 241 would require any application or solicitation for a credit card account to disclose the annual percentage rate, the length or lack of a grace period, any minimum or other periodic fees, and any annual fee or other charges or fees for use of a credit card account. S. 241 would also require card issuers to report this information quarterly to the Federal Reserve Board, which would then pass on such information in the form of annual reports to Congress.

In contrast, S. 616 would impose one set of disclosure requirements on credit cards, and another on charge cards, which are defined as cards providing access to credit which is not subject to a finance charge. Applications and solicitations for credit cards would be required to disclose a multitude of terms, including items such as transaction fees, the means for determining variable rates, and an explanation of the balance computation methods. Applications and solicitations for charge cards, on the other hand, generally would be required to disclose only the annual fee and a statement that the balance is due and payable upon receipt of the bill.

The third bill, S. 647 is not limited to credit cards, but would impose disclosure requirements on applications and solicitations for open-end credit plans offered by banks. As a result, banks, but not other card issuers, would be required to disclose, at the application stage, every term currently required in the full initial disclosure statement mandated by the Truth in Lending Act, together with other information not even required in the initial disclosure statement. In fact, the disclosure requirements of S. 647 are worded in such a vague and inexact manner that it is difficult to determine exactly what disclosure would be required.

II. SPECIFIC ISSUES RAISED BY THE DISCLOSURE PROPOSALS.

A. Scope Of The Disclosure Proposals.

The scope of the three Senate disclosure bills varies widely with respect to the circumstances under which disclosures must be provided, the coverage of particular card issuers, and the treatment of the disclosure requirements within the statutory scheme of the Truth in Lending Act.

1. Only Applications And Solicitations Mailed To Consumers Should Be Covered.

The additional disclosure provisions of any new legislation should apply only to applications and solicitations mailed directly to consumers. Applications and solicitations not directed to particular consumers by name, such as those generally available at merchants, branches and other public locations (known as "rack" or "take-one" applications), or applications

contained in catalogs or magazine advertisements, should not be subject to new disclosure requirements. If "take-one" applications are to be covered at all, the card issuer should be required to provide only an address or phone number where consumers can obtain the required disclosure terms.

Credit card terms can change frequently and it would be difficult, if not impossible, for card issuers to keep current applications at merchant and other public locations. Even if such applications are dated and consumers are invited to request current terms, there is a substantial probability that consumers will rely on the outdated terms printed on the applications themselves. Thus, consumers may not be fully aware of the availability of reduced rates or may be surprised by the increased rates reflected on subsequent disclosure statements.

In addition, some card issuers use different terms in different states, based on the residence of the cardholder. Such card issuers would have to increase significantly the length of their disclosures to reflect all of these potentially applicable terms on applications available at public locations or printed in magazine advertisements. Such lengthy "schedules" of potentially applicable terms are inconsistent with the legislative goal of a simplified disclosure of the most significant credit card terms.

Therefore, any disclosure legislation should exclude "take-one" applications and magazine solicitations from coverage. At most, card issuers should be required to provide only an address or phone number on "take-one" applications where the consumer can obtain the information that would otherwise be required.

All of the proposals currently before the Senate, however, would require disclosures on every application or solicitation for a credit card account, whether mailed to a consumer, made available at merchant or branch locations, or included in catalogs or magazine advertisements. Moreover, S. 616 would actually impose additional requirements on "take-one" applications. First, the bill would require that "take-one" applications include disclosure of the "date on which the application is prepared for distribution to a commercial retail establishment." Many card issuers print thousands of applications at a time. Dating requirements keyed to merchant distribution schedules would greatly increase printing costs, resulting in particularly heavy burdens for smaller creditors.

S. 616 would also require that information on "take-one" applications be "accurate as of the date the applications are distributed to the commercial retail establishments." This requirement could be impossible to satisfy, however, since card issuers frequently use third parties to distribute "take-one" applications and will not know the exact timing of such distributions.

VISA strongly urges this Subcommittee to limit any additional disclosure requirements to applications and solicitations included with written material mailed directly to consumers.

2. Disclosure Provisions Should Apply Equally To All Card Issuers.

None of the current Senate bills applies equally to solicitations and applications for all charge card and credit card accounts. Instead, S. 241 applies only to applications and solicitations for credit card accounts, and S. 647 applies only to open-end consumer credit plans offered by banks. S. 616 would require issuers of charge cards -- even, in some circumstances, charge cards providing access to extensions of credit under open-end consumer credit plans -- to disclose only the annual fee or other charge imposed for the issuance or use of the card and to state that the amount owed is due and payable upon receipt of the statement.

We believe it is vital that both charge cards and credit cards be covered by any legislation mandating additional disclosures, and that such legislation apply equally to credit cards issued by retailers and banks. As a practical matter, travel and entertainment cards like the American Express Gold Card, which provide access to a related standby line of credit, are indistinguishable from, and compete directly with, typical bank credit cards. Holders of these cards can repay in full each month and avoid finance charges, or repay in installments (through access to the standby line of credit) and incur a finance charge. From a competitive standpoint, such a program is the fundamental equivalent of a bank credit card program which offers a one-month grace period. In fact, currently between 10% and 15% of all such Gold Card standby lines of credit are provided by a bank affiliated with American Express itself, and this percentage is increasing. Moreover, even charge cards without a standby credit feature compete directly with credit cards for customers who pay in full each month.

Despite the functional equivalence of such a charge card and a typical credit card, S. 241 and S. 647 would impose additional disclosure requirements only on credit card issuers. In addition, S. 616 would require solicitations or applications for charge cards to disclose only the annual fee or other charge imposed for issuance or use and the fact that the balance is due and payable upon receipt. Furthermore, if a related line of credit is provided by someone other than the card issuer, S. 616 would permit the same abbreviated disclosure, provided the more exhaustive disclosure required of credit card issuers is furnished by the provider of credit before the first extension of credit. This is the same timing currently required under the Truth in Lending Act for initial disclosure statements by all open-end creditors, including credit card issuers.

In addition to the ability to compare competing card products, we believe that personal privacy considerations argue for providing consumers with the opportunity to determine in advance the identity of the creditor that will receive the credit information in an application for any affiliated line of credit. For example, the issuers of charge cards could be required to disclose a telephone number or address at which the consumer could obtain in advance the identity of the creditor that will receive the personal information included in any application for an affiliated line of credit. At the same time, the consumer could obtain the required disclosure terms applicable to that creditor.

We also strongly oppose legislation, such as S. 647, which would exempt credit cards issued by non-bank issuers, such as retailer credit cards, from any additional disclosure requirements. Such cards are indistinguishable from, and compete directly with, bank credit cards. To exempt these cards from additional disclosure provisions would deprive consumers of the opportunity to effectively shop for credit among all competing cards. As a result, we believe that any disclosure requirements imposed on credit card issuers must be made equally applicable to charge cards and cards issued by non-bank institutions.

3. Legislation Should Amend Section 143.

All three bills currently before this Subcommittee would amend Section 127 of the Truth in Lending Act, which establishes the comprehensive initial disclosure requirements for open-end credit accounts. We believe, however, that it would be more appropriate for any such legislation to amend Section 143 of the Act, which governs the advertising of open-end credit plans.

Since the goal of all three bills is to provide consumers with certain limited information on an early basis, these requirements should most appropriately be incorporated into the advertising provisions of Section 143 of the Truth in Lending Act. Indeed, Section 143 already takes into account special forms of advertising such as catalogs.

In addition, the Subcommittee should make it clear that the disclosure of any items required under these bills will not "trigger" the need for additional disclosure under existing Section 143 and corresponding Federal Reserve Board regulations. Presently, these regulations require a card issuer who discloses any of the items which are required as part of the initial disclosure statement to disclose the periodic rates and certain other information as well. Therefore, any new legislation must make it clear that the required disclosure will not trigger the need for additional terms under the existing advertising rules. This clarification can best be accomplished by modification of Section 143 itself.

B. Disclosure Of Principal Terms Only.

Under existing Section 127 of the Truth in Lending Act, consumers already receive complete disclosure of the fees, charges and conditions imposed in connection with credit card accounts prior to becoming obligated for any transactions. Any new disclosure requirements should not substantially duplicate the initial disclosure statement. On the contrary, if a simple method for comparative shopping is the goal, required information should be kept to the absolute minimum to increase the likelihood that consumers will in fact go through the effort of comparison shopping. It should focus on the terms that will always affect the consumer's costs.

Therefore, disclosures should be limited to the annual percentage rate or rates, the dollar amount of any annual or periodic membership or participation fee, and whether or not the consumer will have a grace period during which to repay credit purchases without incurring a finance charge. Such legislation must avoid disclosure of complex terms, such as the circumstances under which a grace period is available, which would require a lengthy description or explanation, particularly where the terms are different for purchase transactions and cash advance transactions under a credit card account. Since the clear purpose of any early disclosure requirement is to allow easy comparison of credit cards and charge cards, the disclosure of terms that must be described or explained in narrative form would be contrary to the goals of the various disclosure bills.

1. Annual Percentage Rate Disclosure Must Accommodate Variable Rates And Should Not Include Periodic Rates.

All three of the current Senate disclosure bills would require disclosure of the annual percentage rate. Since the annual percentage rate is clearly one of the principal disclosure terms for any credit card account, it should be included in any new disclosure legislation. Only S. 616, however, specifically addresses the disclosure of variable rates, requiring the disclosure of both the means for determining the variable rate, and the range of balances to which variable rates are applicable.

We definitely believe that some accommodation for variable rates is necessary in any disclosure legislation. However, greater flexibility in disclosing a variable rate could be provided by requiring a card issuer to disclose the fact that the rate is variable, and then permitting disclosure of either the rate or rates as of a specified date or the means or index for determining the rate. We urge this Subcommittee to adopt this more flexible provision, since the essential information about the rate will be provided to consumers under either method of reporting a variable rate.

In addition, S. 647 may also be interpreted to require disclosure of periodic rates. More specifically, S. 647 would require the disclosure of "any annual or other periodic fee" (emphasis added). Since the goal of the proposed legislation is to provide easily understood summary disclosure of the most significant terms to assist consumers in making informed credit shopping decisions, any credit card disclosure legislation should not require disclosure of periodic rates. The disclosure of such rates does not provide significant additional information to consumers when they are given the annual percentage rate, particularly given the fact that the annual rate is simply the product of the periodic rate and the number of periods in the year. Because this additional information is likely to confuse consumers, VISA strongly urges the Subcommittee to reject any periodic rate disclosure provision of S. 647.

2. Annual Fee Disclosure Must Be Narrowly Defined.

All three of the Senate bills contain some version of an annual fee disclosure requirement. We consider the annual fee to be a principal account term and, thus, an appropriate element of any new disclosure legislation. Nevertheless, any requirement for the disclosure of the annual fee imposed by a card issuer should be limited to the annual or periodic membership or participation fees that may be imposed for the availability of the card account, rather than fees imposed for its use.

On the contrary, however, S. 241 would require the disclosure of "any annual or other charge or fee required to be paid for the use of the credit card." S. 616 would require the disclosure of "[a]ny annual or other fee or charge imposed for the issuance or use of a credit card." Neither bill provides any guidance, though, concerning what the terms "other charge" or "other fee" are intended to cover. Nor do they explain what fees must be disclosed under this legislation for the use of a credit card. These vague phrases could be interpreted as requiring disclosure of all account terms which may result from the use of the account, including all finance charges, late charges or over-limit fees -- terms which are currently disclosed in the initial disclosure statement or the account agreement. This is not the type of essential information that should be provided to consumers engaged in comparison shopping at this preliminary stage.

Furthermore, the phrase "other . . . fee for . . . use" of a credit card in S. 616 could also require the disclosure of transaction charges for cash advances. Since cash advance transactions represent less than 5% of all credit card transactions, such information would not be significant to most consumers at the comparison shopping stage. In addition, many card issuers have differing transaction charges based on whether the advance is a cash or loan advance and whether the advance occurs at the bank or at an ATM. This information should, and currently must,

be included in the initial truth-in-lending disclosure statement. However, listing all such charges as part of the preliminary disclosure would serve only to diminish its effectiveness in helping a consumer decide among competing credit cards.

In addition, S. 647 would require the disclosure of "any annual or other periodic fee," the "amount of any penalties," "any minimum fees or charges," "any transaction fees or charges," and "any other fees or charges." Taken literally, this language would require complete disclosure of all the terms required by the Truth in Lending Act, as well as other terms not so required. Such information simply does not belong in any abbreviated credit card disclosure. Providing such extensive disclosure at the application or solicitation stage would be counter to the legislative aim of providing consumers with summary disclosure for purposes of easy comparison shopping.

3. "Grace Period" Disclosure Should Be Simplified And Made Applicable Only To Purchases.

Both S. 241 and S. 616 would require card issuers to disclose the time period within which credit can be repaid without incurring finance charges, or the lack of such a grace period. S. 647 would require disclosure of "any grace period within which an extension of credit may be repaid without a finance charge," without further explanation. VISA urges this Subcommittee to require credit card solicitations to disclose only the existence or lack of a grace period in connection with purchases of goods and services. A complete description of the grace period would require a detailed explanation of such features as the method of posting debits and credits to the account and forgiveness periods currently permitted under federal law to accommodate mail delays, as well as any distinctions for purchases and cash advance transactions which are permitted or required under state law. Such a lengthy narrative description hardly seems necessary as a preliminary disclosure, particularly given similar language already required in the initial disclosure statement. It could be avoided by legislation that requires only a simple statement that "there is" or "there is not" a grace period.

VISA also urges this Subcommittee to limit any disclosure of the grace period to purchase transactions. Purchase transactions are, by far, the most common credit card transactions. In addition, grace periods are much more likely to be provided on purchase transactions than on cash advances. Since cash advances represent such a small percentage of credit card transactions, a statement of the card issuer's grace period policy with respect to cash advances is not significant credit shopping information to most consumers. In addition, limiting disclosure of grace periods to purchase transactions would simplify the content of the disclosure, provide consumers with the most useful grace period information, and increase the

likelihood that any particular consumer will in fact go through the effort of comparison shopping.

4. No Particular Disclosure Format Should Be Prescribed.

S. 616 would require card issuers to provide disclosure information in a tabular format. Neither S. 241 nor S. 647 addresses the form of disclosure required; presumably, under these proposals, the "clear and conspicuous" standard selected by Congress for the existing Truth in Lending Act would apply.

VISA firmly believes that card issuers should be given the flexibility to provide any required disclosures in a manner which best fits the particular product and circumstances at hand. A "clear and conspicuous" standard should be sufficient in connection with solicitations or applications, just as it has been with the other disclosure requirements currently mandated by the Truth in Lending Act.

The tabular format requirement of S. 616 could lead to protracted and costly litigation and liability for card issuers due to technical formatting violations. Indeed, seven years ago, widespread litigation of this type led Congress to enact the Truth in Lending Simplification and Reform Act of 1980, which replaced similar technical restrictions with a more flexible "clear and conspicuous" standard. The Subcommittee should not ignore this history in considering any new disclosure requirements for credit card accounts.

C. Disclosures Should Be Permitted To Accompany Applications Or Solicitations.

Any credit card disclosure bill should make it clear that card issuers can provide required disclosures on the application itself, or otherwise include such disclosures with the application. Language specifying that disclosures can accompany applications would provide very important flexibility for card issuers, without compromising any consumer benefit. Conversely, any requirement that disclosures actually be printed on the applications themselves would greatly increase the costs of producing such applications.

For example, any requirement that disclosure terms be printed on the application itself could preclude card issuers from printing applications in large quantities to take advantage of volume discounts, since any change in the terms disclosed would force the card issuer to discard its remaining application supply. In addition, such a requirement would preclude a creditor from using the same application form for other lending purposes, such as automobile or student loans. It would also prevent smaller creditors from jointly producing application forms or buying standard application forms. Accordingly, a card

issuer should have the flexibility of providing required disclosures on or with its application forms.

D. Preemption Of State Law.

The intent of the various disclosure bills before this Subcommittee is to provide consumers with a simple, uniform disclosure of the most significant credit terms to facilitate easy comparison shopping among card programs. To accomplish this, it is important that individual states not be allowed to vary the content, circumstances or manner of the disclosure. Thus, complete federal preemption of similar state disclosure requirements is essential.

Of the bills currently before this Subcommittee, only S. 616 addresses the issue of federal preemption. It provides that state law is not preempted if "the law of the State explicitly requires the disclosure of such information in a credit card application or solicitation." Because any state law imposing disclosure requirements on credit card applications or solicitations likely would satisfy this minimal standard, the federal preemption provision in S. 616 would preempt very little. Accordingly, the objective of uniform, concise, early credit card disclosures could be totally frustrated by inconsistent state laws.

Without a stronger federal preemption standard than that in S. 616, disclosure compliance will be unduly complicated for national and regional card issuers, who could be forced to comply with differing state and federal disclosure requirements. Moreover, differing state standards would make it difficult, if not impossible, for consumers to compare cards being offered by creditors operating in different states or regions. Therefore, VISA strongly urges that any disclosure legislation provide for the complete federal preemption of all state law with respect to such disclosures.

E. Transition Period.

VISA also requests that the Subcommittee include an adequate transition period in any disclosure legislation. During this transition period, the Federal Reserve Board will be required to draft and publish for comment a proposed new consumer disclosure regulation, review and incorporate comments from those affected, and publish a final regulation. Thereafter, card issuers will be required to reprint new application forms and may be required to collect and destroy application forms then in circulation.

S. 647 would provide an effective date of January 1, 1988. Since it is impossible to predict exactly when disclosure legislation will be enacted by Congress, such an inflexible effective date would not guarantee sufficient time to draft

regulations and institute compliance programs. S. 241, at the other extreme, provides no specific effective date, and thus would be effective on enactment. As a result, S. 241 would provide no opportunity to draft regulations or institute compliance programs.

S. 616 would not only require card issuers to be in full compliance with the resulting Federal Reserve Board regulations within 90 days of the effective date of such regulations, but would also require the Federal Reserve Board to issue regulations in final form within 90 days of the enactment of the law. Such an abbreviated time frame would impose an unreasonable strain on the resources of the Federal Reserve Board and card issuers alike. Hastily fashioned regulations and compliance efforts can lead to subsequent regulatory revisions and compliance errors, causing consumer uncertainty and unnecessary card issuer expense.

VISA strongly urges this Subcommittee to grant the Federal Reserve Board sufficient time to promulgate the contemplated regulations, and to grant card issuers at least six months after the final promulgation of these regulations to comply with the new disclosure requirements.

III. PROPOSAL TO LIMIT INTEREST RATES.

S. 242, introduced by Senator D'Amato, would limit the interest rates on credit card accounts to 4% over "the ratio established under Section 6621 of the Internal Revenue Code of 1954." It is not clear from the language of S. 242 exactly what rate would apply, since Section 6621 provides for three different rates -- the "Overpayment Rate," the "Underpayment Rate," and the "Short Term Federal Rate." In addition, Section 2 of S. 647 would limit the rate of interest charged on consumer credit card accounts to no more than 6% above the average Federal Reserve discount rate for the previous six months, as determined each calendar quarter. VISA strongly opposes any legislation to impose an artificial ceiling or cap on credit card interest rates.

A. Credit Card Interest Rates Are Not Unreasonably High.

In 1985, VISA, in cooperation with the American Bankers Association and MasterCard International, commissioned the economic research firm of Lexecon, Inc. to analyze the effect of interest rate controls on credit cards. The results of this study (the "Lexecon Study") demonstrate unequivocally that an interest rate cap is not warranted by the conditions existing in the current credit card market.

Proponents of interest rate caps point to the difference between credit card interest rates and rates charged for other forms of consumer credit, arguing that the higher interest rates

on credit cards constitute pure profit for the credit card issuers. When the actual finance charges paid by consumers are taken into account, however, credit card interest rates are not, in fact, significantly higher than rates charged for other forms of consumer credit. The nominal annual percentage rate is not an accurate reflection of the actual cost of credit under a credit card account. The one-month, interest-free grace period offered by most card issuers for purchase transactions results in an effective interest rate that is significantly lower than the nominal rate. For example, the Federal Reserve Board has found that 47% of all credit card customers almost always pay their monthly bills in full. Thus, such customers have an effective annual percentage rate of 0%.

The Lexecon Study found that these "convenience cardholders," who use their cards as a transaction device rather than a means of accessing credit, tend to use their cards more actively than others. In fact, about 50% of the dollar volume of credit card purchases is paid without incurring interest. The Lexecon Study further found that amounts charged to credit card accounts that are not paid within the grace period remain outstanding for an average of five months, and concluded that 5/6 of all outstanding balances are earning interest at any time. Thus, a nominal interest rate of 18% translates to an effective interest rate of about 15%.

Furthermore, credit card programs are far more costly to administer than other consumer credit programs. The cost of funds in a credit card program represents only 40% of the cost of a credit card transaction. The remaining 60% of the cost is attributable to salaries, overhead, postage, and technology. In particular, the technology costs of capital investment for, and operation of, worldwide authorization and transaction clearing systems are enormous, and such costs do not drop with the prime rate. Also, because credit card loans are unsecured, losses due to bankruptcy, fraud, and bad debts are higher than for many other forms of credit.

Credit advances within a card program also cost more to administer than other consumer loans. Instead of merely processing an initial application and mailing out a coupon book, credit card transactions can involve sales slips and authorizations for nearly all transactions. In addition, credit card issuers must comply with both initial and ongoing disclosure requirements, prepare and distribute monthly billing statements, and respond to cardholder inquiries -- all of which are mandated by existing federal law.

VISA also believes that increased consumer use of credit cards indicates that consumers believe interest rates charged on credit cards are reasonable, relative to the benefits offered through such cards. The Lexecon Study found that credit card purchasing as a percentage of personal consumption expenditures

EXHIBIT C*

GROWTH IN BANK REVOLVING CREDIT, BY STATE GROUPS, 1980-1984

	Real Growth, 1980-84	Share of U.S. Revolving Credit		
		1980	1984	% Change
States with No Interest Rate Controls	83.5%	54.9%	62.5%	13.8%
States with Moderate Interest Rate Controls	30.5%	21.5%	17.3%	-19.5%
States with Strict Interest Rate Controls	39.7%	23.6%	20.2%	-14.4%
(Arkansas	-4.8%	.17%	.10%	-41.2%)
All States	62.7%	100.0%	100.0%	

Source: Federal Reserve Board, Consumer Price Index, and The AECS Review No. 247-48 (June-July 1985) 18-19 (Table 6).

Note: "No control" states are AZ, CA, DE, IL, MT, NH, NJ, NM, NV, NY, OR, SC, SD, VA.

"Moderate control" states are AL, CO, DC, IA, ID, IN, KS, KY, MA, MD, ME, MS, OH, OK, RI, TN, TX, WI, WY.

"Strict control" states are AK, AR, CT, FL, GA, HI, LA, MI, MN, MO, NC, ND, NE, PA, UT, VT, WA, WV.

Breakdown is as of August 1982. Subsequently, three additional states (IA, ID, and NE) abolished rate controls on credit cards and one additional state (UT) relaxed its controls from 18 percent to a higher ceiling.

* Taken from "Interest Rate Controls on Credit Cards -- An Economic Analysis," Lexecon Inc., October 1985.

Senator DODD. Thank you very much, Mr. Wiesler, for your testimony. Mr. Silberstein.

STATEMENT OF ALAN M. SILBERSTEIN, SENIOR VICE PRESIDENT, CHEMICAL BANK OF NEW YORK, REPRESENTING MASTERCARD

Mr. SILBERSTEIN. Senator Dodd and Senator Sasser. My name is Alan Silberstein. I am a senior vice president of Chemical Bank in New York. I am appearing here today on behalf of MasterCard International and its more than 25,000 worldwide members.

MasterCard appreciates the opportunity to testify before the subcommittee on the important proposed credit card legislation you are considering. This legislation would require additional disclosures with respect to credit card applications and solicitations and would establish maximum interest rates that could be charged in connection with credit card accounts.

In addition to my testimony here today, MasterCard has submitted a detailed written statement, which we understand will become part of the record of the hearing.

MasterCard has supported, and continues to support, disclosure legislation, provided that it would, in appropriate instances, provide consumers with clear and concise early disclosure of the key terms of card programs. The legislation introduced in the House of Representatives by Congressman Doug Barnard, H.R. 1086, best conforms to this disclosure approach, and MasterCard strongly endorses Mr. Barnard's bill. We believe that Mr. Barnard's approach, which best matches the solution with the problem, without creating new problems, is the most appropriate approach to take. It serves the interests of the American consumer and does not impose an undue level of regulatory burden on the issuers of bank credit cards.

MasterCard can not support any of the disclosure bills currently pending in the Senate, unless these bills are amended to address the following concerns:

First, MasterCard believes that any new disclosure requirements with respect to applications and solicitations should be limited to just the principal terms considered by consumers in selecting a credit card. These principal terms are the annual percentage rate, the dollar amount of any annual or periodic membership fee and whether or not the program offers a grace period.

In addition, where a card is issued with a variable rate, we believe the issuer should be required to disclose that fact, along with either the rate as of a specified date or the index or other means used in determining the rate.

MasterCard believes that it is unnecessary to require disclosure of any additional information beyond these principal terms at the application and solicitation stage. Examples of such information would be charges resulting from the use of the account or lengthy descriptions of grace periods, as would be required under certain of the Senate bills. It would make the early disclosures unduly complex and intimidating for consumers. In fact, we believe it would substantially reduce the likelihood that consumers would use these disclosures for comparison shopping among credit cards. Moreover,

disclosure of this additional information would be largely superfluous to the existing disclosure of the fees, charges and other terms already provided to consumers in an initial disclosure statement. It should be emphasized that these statements are provided to consumers before they become obligated for charges for credit card usage.

Second, it is not necessary or justified for Congress to legislate the specific manner in which the required information should be disclosed. The existing clear and conspicious standard established under the Truth-in-Lending Act would apply to disclosures in connection with applications or solicitations. This standard should ensure that such information is effectively and adequately disclosed to consumers.

A statutory requirement specifying a particular disclosure format, such as the tabular formatting requirements of S. 616, might well lead to protracted and costly litigation and liability for card issuers due solely to technical violations. Indeed, it was precisely this type of widespread litigation involving alleged technical violations of the Truth-in-Lending Act that motivated the Congress in 1980 to replace technical disclosure requirements with the clear and conspicuous standard that I just mentioned.

Third, MasterCard believes that any requirements for early disclosure should apply only to applications and solicitations mailed directly to consumers. All three of the bills currently pending before the Senate would require disclosure in connection with applications and solicitations not directed to a consumer by name, such as so-called "Take One" applications or applications included in magazines. This is unnecessary, and we think, unwise.

Credit card terms can change frequently. It would be difficult, if not impossible, for card issuers to ensure that all applications at merchant and other public locations are current. Even if such applications were dated and consumers were invited to request current terms, as required by S. 616, consumers could easily be misled by the outdated terms printed on the applications themselves. Such dating requirements also would greatly increase printing costs.

In addition, lengthy disclosures would be required for card issuers with programs having different terms for different cardholders. This would clearly run contrary to the legislative goal of providing consumers with simple universal data for comparison shopping purposes.

Fourth, it is essential that any disclosure requirements apply equally to all charge card and credit card issuers. None of the bills currently pending in the Senate provide for such equal treatment. Credit cards issued by nonbank issuers, which offer a related standby line of credit, are functionally equivalent to credit cards issued by banks. Even charge cards without the standby credit feature compete directly with bank-issued cards for those credit card customers who generally pay in full each month, without incurring any interest charges. Almost half of all credit card customers fall into this category.

It is important to keep in mind that 80 percent of cards are issued by entities other than banks. Failure to treat issuers of all credit cards and charge cards equally would, in effect, deny consumers the very benefits the legislation hopes to achieve. It would

also be unfair to those card issuers subject to the greater disclosure requirements.

Finally with respect to disclosure, for the reasons discussed in our written statement, we also believe that any disclosure legislation should amend section 143 of the Truth-in-Lending Act, effectively preempt State requirements addressing this subject area, and provide for an effective date of at least 6 months after final promulgation of Federal Reserve regulations.

Turning from disclosure legislation to the proposed credit card interest rate caps, let me say that MasterCard is adamantly opposed to any credit card interest rate cap legislation. I was quite pleased to hear Chairman Dodd's statement at the beginning of this hearing that he too believes that cap legislation is the wrong solution.

Legislating credit card interest rate caps would have the same unfortuante effect as the old mortgage rate caps had in the home lending business. Mortgage rate caps drove many lenders out of the business and only made it more difficult for consumers to finance housing.

In considering credit card interest rates, it is important to keep in mind the enormous fixed and other costs associated with credit card services, as compared with other forms of consumer and business credit. Indeed, the cost of funds in a credit card program represents less than 40 percent of the costs associated with these services. Accordingly, rates on credit card plans cannot be expected to move in lock step with other interest rates.

Again, on behalf of MasterCard, I want to thank you for the opportunity to present our position, and I would be pleased to answer any questions.

[Complete prepared statement of Mr. Alan Silberstein follows:]

(excluding housing) grew 19% from 1980 through June 1985 -- from about 12.6% to 15% of expenditures. Thus, consumers rely on credit cards, using them increasingly like currency. Consumers value the convenience of being able to instantly obtain small amounts of credit at the point of sale, with immediate lender authorization options available on larger purchases. Consumers also value the flexibility of repayment options available through credit card plans, including the option under most credit card programs of paying in full monthly without interest. Credit cards also provide otherwise unobtainable access to traditional sources of credit for many young and low-income consumers.

B. A Credit Card Interest Rate Cap Would Have Anti-competitive Effects On The Credit Card Industry.

VISA also believes that credit card cap legislation is unwise. Instead of increasing competition, a credit card rate cap could actually decrease the number of institutions offering credit cards and the number of consumers who would qualify for credit cards.

Fierce competition currently exists in the credit card market. The Lexecon Study indicated that the single largest credit card issuer, Sears, accounted for only about 11% of all credit card balances outstanding at the end of 1984. The second largest issuer, Citicorp, accounted for only 4% of the outstanding credit balances. Indeed, the largest ten issuers together accounted for only about 34% of credit card credit. (See Exhibit A.) The Lexecon Study also calculated the Herfindahl-Hirshman Index ("HHI") of market concentration for credit card supply, and arrived at a figure of 200-225; the Department of Justice considers markets with an HHI of less than 1,000 to be "unconcentrated." Such statistics, as well as the fact that credit card issuers must compete with suppliers of other forms of consumer credit, demonstrate that the current credit card market is, without a doubt, a highly competitive market. (See Exhibit B.)

Indeed, empirical evidence from the pages of today's newspapers amply demonstrates exactly how competitive the credit card market is. The recent drop in the cost of funds has made credit cards more profitable, and competition is increasing. This competition is already driving credit card interest rates down. Many credit card issuers around the country have implemented or announced reductions in their credit card interest rates.

Basic economic principles argue against imposing a price ceiling on such a competitive market. Price ceilings set at below market-clearing levels on such a competitive market will invariably create a gap between supply and demand. Consumers will demand more of the product, which would be priced at below-market rates. Producers will supply less; some will be forced

out of business, and others will reduce their production to the level where marginal production costs meet the controlled price. Deprived of the most efficient means for closing this gap between supply and demand -- raising prices -- the suppliers must turn to other means.

In the credit card market, as in any market, card issuers are likely to respond by raising prices in uncontrolled areas, by, for example, raising annual interest rates, or eliminating or reducing grace periods. Credit card issuers are also likely to cease offering the "product" to lower-income consumers, thus cutting another "cost of production" -- higher-risk credit.

VISA also urges this Subcommittee to consider prior experiences with attempts to restrict credit card interest rates. Restrictive usury laws of the late 1970s and early 1980s caused credit card issuers to limit their services, offering credit only to high-income customers, or to drop out of the market altogether. (See Exhibit C.) Moreover, the Arkansas experience with interest rate ceilings tied to the discount rate has discouraged the issuance of credit cards or limited their issuance to higher socio-economic levels, driving other consumers to more costly forms of credit.

Therefore, VISA strongly urges this Subcommittee to reject any legislation that would impose an arbitrary interest rate ceiling on credit card accounts.

* * * * *

Again, VISA appreciates the opportunity to testify before this Subcommittee on legislative issues of significance to cardholders and card issuers alike.

Suppliers of Credit Card Credit, 1984
(Percent of Total Outstanding Credit Card Balances)

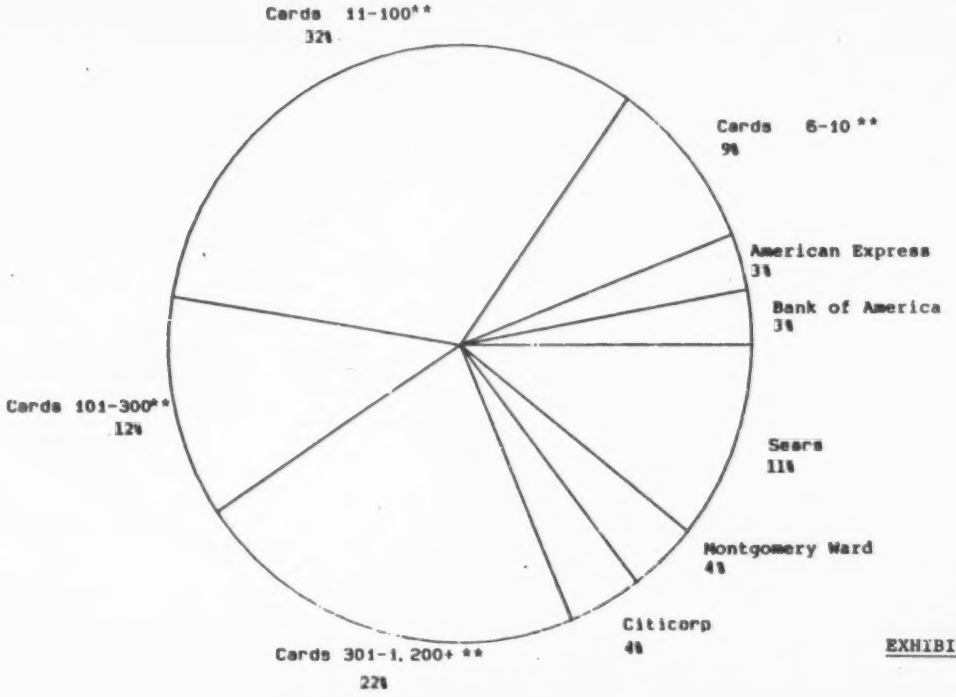

EXHIBIT A*

* Adapted from "Interest Rate Controls on Credit Cards -- An Economic Analysis," Lexecon Inc., October 1985.

** Numbers refer to rank of card issuer, calculated from percentage of credit card market supplied.

Table 2

CREDIT CARD CREDIT AND OTHER CONSUMER CREDIT, 1984

	Amount outstanding (billions)	% of credit-card credit	% of consumer credit
1. All consumer credit	$577.1		100.0 %
2. Credit card credit	108.0	100.0 %	18.7
a. Bank card credit	54.9	50.8	9.5
b. Retail card credit	45.6	42.2	7.9
c. Gas and other card credit	7.5	6.9	1.3
3. Credit card issuers			
a. Ten largest issuers	$ 36.8	34.0 %	6.4 %
Sears	11.6	10.7	2.0
Citicorp	4.4	4.1	0.8
Montgomery Ward	4.2	3.9	0.7
Bank of America	3.3	3.1	0.6
American Express	3.2	3.0	0.6
J.C. Penney	3.2	3.0	0.6
First of Chicago	2.3	2.1	0.4
Chemical Bank	1.6	1.5	0.3
Chase Manhattan	1.6	1.5	0.3
Manufacturers Bank	1.3	1.2	0.2
b. Top 100 issuers (estimate)	$ 71	66 %	12 %
c. Top 300 issuers (estimate)	$ 84	78 %	15 %

Source: Federal Reserve Bulletin, September 1985, Table 1.55 (p.A40); The Nilson Report, No. 347 (Jan. 1985) 4-5, No. 339 (Sept. 1984) 6-7, No. 338 (Aug. 1984) 4-5, No. 337 (Aug. 1984) 4-5.

Note: Estimates for top 100 and top 300 card issuers derived by taking sums of published outstanding balances for top 100 and 300 bank cards in 1983 and extrapolating to incorporate 1983-4 growth and non-bank credit card balances.

EXHIBIT B*

* Taken from "Interest Rate Controls on Credit Cards -- An Economic Analysis," Lexecon Inc., October 1985.

TESTIMONY OF
MASTERCARD INTERNATIONAL, INC.
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS
OF THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
UNITED STATES SENATE
MARCH 26, 1987

Mr. Chairman, members of the Subcommittee, I am Alan Silberstein, a Senior Vice President at Chemical Bank in New York. I am here today to testify on behalf of MasterCard International, Inc. ("MasterCard").1 MasterCard would like to thank the Subcommittee for the opportunity to testify on the very important legislation before this Subcommittee, which would require additional disclosures with respect to credit card applications and solicitations and would establish maximum interest rates that could be charged in connection with credit card accounts.

MasterCard has supported, and continues to support, disclosure legislation that would, in appropriate instances, provide consumers with clear and concise "early" disclosure of the key terms of card programs, provided such legislation does not impose undue burdens on card issuers. As discussed below, MasterCard believes that any such legislation should require all issuers of charge cards and credit cards to disclose the most significant card plan terms, namely the annual percentage rate, the annual fee and existence of a grace period, in a clear and conspicuous manner in connection with applications and solicitations mailed directly to consumers. MasterCard firmly believes that the disclosure of these most important terms would enable consumers to engage in easy comparison shopping among different card programs and, just as important, would encourage consumers to do so.

The legislation introduced in the House of Representatives by Congressman Doug Barnard of Georgia (H.R. 1086) best conforms to this disclosure approach and MasterCard strongly endorses that legislation. For the reasons discussed below, however, MasterCard cannot support any of the disclosure bills currently pending before this Subcommittee -- S. 241 introduced by Senator D'Amato of New York, S. 616 introduced by Chairman Dodd of Connecticut and S. 647 introduced by Senator Sasser of Tennessee -- unless these bills are amended to address the concerns discussed below.

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1 MasterCard is a membership organization comprised of financial institutions which are licensed to use the MasterCard service marks in connection with payment services, including credit cards.

MasterCard adamantly opposes any legislation that would artificially limit interest rates on credit card accounts, such as S. 242 and S. 647. As discussed in this testimony, such credit card interest rate "cap" legislation is not needed, and would result in a misallocation of resources given the vigorous competition in the credit card market. Moreover, such a rate ceiling would, as analogous historical experiences have clearly shown, adversely affect many consumers. Accordingly, MasterCard heartily endorses the position of Chairman Dodd, as reported in the March 20, 1987 issue of The American Banker, that this Subcommittee will not report any credit card legislation to the Senate Banking Committee, if the House of Representatives continues to pursue legislation that would impose limitations on credit card interest rates.

I. The Elements Of Effective Credit Card Disclosure Legislation.

A. What Should Be Disclosed.

As indicated above, MasterCard believes that any new disclosure requirements for applications and solicitations should be limited to the principal terms affecting the consumer's selection of a credit card: the annual percentage rate or rates, the dollar amount of any annual or periodic membership or participation fee, and whether or not the consumer will have a grace period during which to repay credit purchases without incurring a finance charge. The issuer of a card with a variable rate should also be specifically required to disclose the fact that the rate is variable and either the rate or rates as of a specified date or the means or index for determining the rate. Disclosure limited to these key terms will enable consumers to engage in effective comparison shopping among competing card programs, without being subjected to ensuing information overload.

MasterCard firmly believes that requiring any additional information to be disclosed at the application and solicitation stage beyond these principal terms would make the disclosures unduly complex and intimidating for the consumer and, thus, substantially reduce the likelihood that a consumer will utilize the disclosures in the context of card comparison shopping -- the principal objective of the legislation. Moreover, further disclosures required in connection with applications or solicitations would be largely superfluous to the fullsome disclosure of the fees, charges and conditions imposed in connection with credit accounts currently provided to the consumer, prior to the consumer becoming obligated under the card plan, pursuant to Section 127 of the Truth in Lending Act.

B. How Should The Disclosures Be Made.

It is not necessary or appropriate for any disclosure bill to legislate the specific manner in which the requisite

Perhaps most importantly, MasterCard believes that artificial limitations on credit card rates would adversely affect many consumers. The experiences with the restrictive usury laws of the late 1970s and early 1980s suggest that limitations on credit card interest rates discourage the issuance of credit cards and limit their issuance to higher income levels, driving others to more costly forms of credit.

Senator DODD. Thank you very much, all three of you for your testimony here this morning—this afternoon now, I should say. I look forward to your response to questions. I will start by thanking you, Ms. Fernstrom, for your support of our efforts here and just say to you Mr. Silberstein, I appreciate MasterCard's position in all of this. Particularly regarding my own comments about the cap approach. But I will repeat again what I've said and I presume you've heard me say.

You may have difficulties with disclosure, but if we don't do something in the disclosure area, I will tell you right now that the train is moving and consumers are reacting, and we are going to end up with caps, if we don't do something and give the marketplace a chance to function with the disclosure method.

Let me just start with some questions. I know none of you have included any of these comments in your testimony, but obviously, with Congressman Schumer's announcement here this morning regarding President Russell's letter to Mr. Meese, Mr. Wiesler, I have to put you on the spot, since you're the only guy we have there this morning, so you're the man of the hour here.

This Western Union Mailogram sent out on March 11, 1987. I wonder if you might tell us how this kind of a letter enhances competition.

CONTROVERSIAL LETTER

Mr. WIESLER. Well, I think probably the letter has been misinterpreted by many people, many people within VISA have not misinterpreted it. We are an association of over 18,000 members and over 4,000 issuers, and Mr. Russell did send a letter out, as he does frequently on many issues that affect the marketplace, alerting our issuers and some of our members where they are affected about new competition, developments in the marketplace.

He was barely quickly getting out to the fact that American Express had come out with a new Optima card at a 13.5 percent rate and was trying to point out in the Mailogram that they ought to be aware of it, and the fact is that they had to have——

Senator DODD. But it is more than just aware. This is a hell of an awareness letter. Jim Robinson, I wonder how many calls he got. You've got his telephone—is that his home phone or his business phone?

Mr. WIESLER. I understand he got very few.

Senator DODD. Well, that's encouraging.

Mr. WIESLER. So our members have always been very, very independent. We don't try to tell them what to do. We make concessions to them.

Senator DODD. Well, sure you do. Now, wait, wait, wait, wait. You may wish to rethink your position in offering American Ex-

press products. I mean, you are certainly making recommendations as to what they might want to do.

Mr. WIESLER. You may wish to. We didn't recommend that they do it. We just say——

Senator DODD. Now we're getting pretty semantical.

Mr. WIESLER. No, that is not a recommendation, and that went to individual——

Senator DODD. "This will have a far greater effect on your bank profits. American Express is experienced in dealing with merchants. They have a proven product in the marketplace. You may want to question getting involved." That is not what I would call promoting.

Mr. WIESLER. What Mr. Russell is trying to point out there that maybe there is a fox in the chicken coop, perhaps.

Senator DODD. Well, why didn't he say that here? What's the fox?

Mr. WIESLER. Well, the fox is American Express.

Senator DODD. Maybe 13.5 percent is the fox.

Mr. WIESLER. In other words, American Express is developing a lot of business of their products with the consumer.

Senator DODD. Because they are offering a lower rate.

Mr. WIESLER. No. Pardon me. American Express is saying to the banks that they do business with, we are not going to compete against you directly, but we would like you to sell our products and to do various things. And then on the other hand, they make statements that, you know, we, indeed, intend to be competitive into the financial service business, and that we do intend to acquire other financial services institutions and compete. And Mr. Russell is merely alerting themselves to the fact that perhaps that you have a fox in the chicken coop, that perhaps the 13½ percent itself is a little bit misleading, because in order to get the 13½ percent, you have to have two cards, and the combination of two cards, the cheapest that you can have is $60, and——

Senator DODD. Well, we can get to that in 1 minute. I think that is a legitimate point, as to whether or not the charge card and the credit card are the same thing. Are you familiar with the letter? I mean, have you been briefed about this?

Mr. WIESLER [continuing]. I read the letter, yes.

Senator DODD. But have you discussed this with the people at the company?

Mr. WIESLER. Oh, absolutely.

Senator DODD. Because I don't want to—there's no point in me——

Mr. WIESLER. No, as a member of the board and as a member of the executive committee for a number of years, I am very concerned——

Senator DODD [continuing]. Was this something Mr. Russell did on his own, or was this something that was discussed among the board members and others? I'm wondering about any legal opinions. I mean, you've got a——

Mr. WIESLER [continuing]. Oh, yes. We had legal opinions.

Senator DODD [continuing]. Prior to the letter going out or the Mailogram going out?

Mr. WIESLER. Yes. Absolutely.

Senator DODD. And the conclusion of your legal department was, this is not going to violate any illegal boycotts?

Mr. WIESLER. Absolutely. And furthermore, we would welcome an investigation by the Justice Department. We really would.

Senator DODD. Ms. Fernstrom, what has American Express done in reaction to Mr. Russell's suggestions?

Ms. FERNSTROM. Well, Mr. Chairman, we feel that we really don't have to initiate any reaction to his letter. We believe that our product speaks for itself. I would like to point out that the Optima card will be offered only to our card members. It was not designed to compete head on with VISA in the marketplace. A card member has to be a member in good standing for 1 year before they will be eligible for this card, and it is not a stand-alone product. It is only offered as a companion to existing American Express card.

Senator DODD. Have you had any banks respond positively to Mr. Russell's suggestion that they drop American Express products? Has that happened at any banks?

Ms. FERNSTROM. I am not personally aware of the reaction. I know that Mr. Robinson did receive only a handful of phone calls the day or 2 after the Mailgram went out, but I would be happy to get back to your staff.

Senator DODD. I wonder if you might provide the committee—I would be interested to know whether or not any—what's the reaction of American Express to the whole episode? I appreciate your being diplomatic, but I didn't purposely put the two of you sitting right next to each other. [Laughter.]

Mr. WIESLER. Friendly competitors.

Ms. FERNSTROM. Well, we're not only friendly competitors, we're also business partners in many instances. As Mr. Wiesler rightly pointed out, the banks, thousands of them throughout the country, sell American Express products, such as our travelers cheques and money orders to our mutual customers.

Senator DODD. But would American Express do something like this?

Ms. FERNSTROM. I would like to think that we wouldn't.

Senator DODD. So you have more—this is more what you would consider just sort of healthy competition?

Ms. FERNSTROM. Yes, sir. We feel—as long as the animal analogies have been brought up—that it's become a case of the tail wagging the dog, and that the VISA organization, it appears, has gotten out of control of the banks and is exercising more of its own special interests rather than the interests of the banks and certainly not the interests of consumers.

Senator DODD. Well, all right. Let me come back and ask the point that Mr. Wiesler was suggesting, and obviously, what we are talking about here is a charge card. It is a bit different than a credit card, and so there is maybe some confusion, and I am sure that consumers can necessarily make that distinction between a charge card and a credit card. I think they use the words interchangeably, would be my own mind. I mean, I think of myself—if someone asks me if I have a charge card, I would probably say yes. Then I would pull out my—what I possess, all three of them, my cards. I wouldn't be thinking of something different. You see how equitable I am? I actually have a—I shouldn't maybe have told you

that. You're going to run out now and check and see how I'm doing. [Laughter.]

I always dread when they make the phone call on the purchase. I suppose we all go through that.

But I wonder if you might express for us, Ms. Fernstrom, considering the access to the lines of credit, obviously, with a charge card, of making the same disclosure requirements on the charge card. Now you've expressed that you feel that that should not be the case, and that—the reason being the difficulty of knowing which bank would be offering the line of credit makes it difficult, I suppose, for American Express.

It's been suggested that it might be fair to require disclosure of the annual percentage rate by the bank at some time, perhaps 10 days, one suggestion was, before the card is actually sent to the consumer.

I wonder if you might comment on a suggestion like that, so that we do apply a disclosure requirement here on the charge card as well.

DISCLOSURES TO LINES OF CREDIT

Ms. FERNSTROM. Well, it is my understanding that S. 616 does not apply to lines of credit per se, and I think that if in your judgment you decide to apply disclosures to lines of credit, we have no problem with that. As I understand it, Truth in Lending apparently covers disclosure requirements for lines of credit, and the banks that offer lines of credit in our Gold Card program fully comply with those disclosure requirements, but again, if the committee judges that further disclosures are required about lines of credit, we would have no problem with that.

Senator DODD. I am probably less concerned about the kind of a customer you're dealing with there, because that is your top-rated customer that would qualify for the Optima card or a card similar to that. In my own view, in that kind of situation they're probably better prepared to make those kind of consumer choices, as opposed to when you have the generic solicitation to people, regardless of their own ability or an examination of credit. In that case, a fuller disclosure is more appropriate. I mean, I'm just speaking sort of off the top of my head. Maybe there is some reason for applying it across-the-board. But that's my own reaction.

Let me just ask you one quick question. My time is about to run out here. And it's on another subject, but it is a matter that came up, and I would like to query you about it, if I could, Ms. Fernstrom.

I wonder if you might tell us what American Express does when there is unusual activity in an account, for instance, when someone has a—an individual never charged more than $1,000, say, and then charges $7,000. There is unusual activity in that particular account. Would American Express contact the individual or request information at that particular point? What is the business practice when you have that kind of unusual behavior?

Ms. FERNSTROM. As you mentioned earlier, the card member might get called to the phone in a retail establishment or at the place of purchase that they were using their card. We want to

information must be disclosed. The existing "clear and conspicuous" standard of Section 122 of the Truth in Lending Act, which would apply to disclosures in connection with applications or solicitations, would ensure that such information is effectively disclosed to consumers, just as it does now for the full panoply of disclosures mandated under the Truth in Lending Act.

A statutory requirement specifying a particular disclosure format might well lead to protracted and costly litigation and liability for card issuers due to technical violations. It was precisely this type of widespread litigation involving alleged technical violations of the Truth in Lending Act that motivated Congress in 1980 to generally replace the technical requirements concerning the manner of disclosure in the Act with the clear and conspicuous disclosure standard mentioned above. This standard has worked quite well with respect to other disclosures required under the Truth in Lending Act and there is no reason to suspect that it will not be as effective in this disclosure context.

Moreover, a specified disclosure format could result in significantly increased costs to card issuers, which would ultimately be passed along to the consumers. For example, a requirement mandating that disclosures appear on an application itself would greatly increase costs for many card issuers, particularly smaller card issuers, by precluding card issuers from (1) printing applications in large quantities, since any change in the terms would force the card issuer to discard its remaining inventory of applications, (2) using the same form for other lending purposes, and (3) producing application forms jointly with other card issuers or buying standard application forms. Indeed, as opposed to prescribing a particular disclosure format, the legislation should make it clear that required disclosures may accompany, rather than be a part of, the application.

C. When Should Disclosures Be Made.

Any required early disclosures should apply only to applications and solicitations for charge cards and credit cards mailed directly to consumers.

The legislation should not require disclosure in connection with applications and solicitations not directed to particular customers by name, such as those generally available to the public (so-called "rack" or "take-one" applications) or applications in magazine advertisements. Credit card terms can change frequently and it would be difficult, if not impossible, for card issuers to keep current applications at merchant and other public locations. Even if such applications were dated and consumers were invited to request current terms, consumers could easily be misled by outdated terms printed on the applications themselves. In addition, such dating requirements would greatly

increase the cost of printing such applications, particularly for smaller card issuers, primarily because of the loss of volume discounts with respect to the printing of the applications discussed above.

Moreover, if the disclosure requirements were applicable to applications available at public locations or printed in magazine advertisements, card issuers with programs having different terms applicable to card holders residing in different states could be required to include lengthy and complex schedules of information in such applications. These detailed schedules would be clearly inconsistent with the legislative goal of providing consumers with simple and usable information so that they can easily compare different card programs.

MasterCard also believes that it is essential that the disclosure requirements apply equally to all charge card and credit card accounts. Credit cards issued by non-bank issuers, such as retailer credit cards, and travel and entertainment cards which offer a related standby line of credit, are functionally equivalent to, and compete fully with, credit cards issued by banks. Even charge cards without a standby credit feature compete directly with bank-issued credit cards for those customers who generally pay in full each month (who, according to Federal Reserve Board studies, comprise approximately 47% of all credit card customers). Failure to treat issuers of all charge cards and credit cards equally would not only be unfair to those card issuers subject to greater disclosure requirements, but also would be unfair to consumers who would be deprived of the opportunity to effectively choose from all competing card programs.

D. Other Issues.

Any disclosure legislation should clearly provide for the explicit federal preemption of state disclosure requirements addressing this subject area. There should be no exceptions from this preemption. Consumers will be able to effectively shop among available cards only if all card issuers throughout the nation are subject to the same disclosure requirements. Moreover, disclosure compliance would be unduly complicated and costly for national and regional card issuers if they are forced to comply with differing federal and state disclosure requirements.

Any disclosure legislation should amend Section 143 of the Truth in Lending Act, since these types of disclosure most appropriately fall within the scope of Section 143, which governs advertising. Moreover, the legislation should make clear that the required disclosures do not trigger any additional disclosures under Section 143 and applicable Federal Reserve regulations. This result can best be accomplished if the disclosure legislation amends Section 143.

Finally, the disclosure legislation should provide for an effective date sufficiently in the future to permit the Federal Reserve Board to promulgate regulations and card issuers to take all necessary actions, such as reprinting new forms and collecting and destroying old forms. MasterCard believes that card issuers will need at least six months after final promulgation of Federal Reserve Board regulations to comply with any new disclosure requirements.

II. Analysis Of Proposed Disclosure Legislation Pending In The Senate.

A. The Pending Senate Bills.

S. 241 would require any application or solicitation for a credit card account to disclose the annual percentage rate, the length or lack of a grace period, any minimum or other periodic fees, and annual or other charges or fees. This bill would also require card issuers to report this information quarterly to the Federal Reserve Board, which would then make this information available in the form of annual reports to Congress.

S. 616 would impose one set of disclosure requirements on credit cards, and another on charge cards, which are defined as cards providing access to credit which is not subject to a finance charge. Applications and solicitations for credit cards would be required to disclose a multitude of terms, including items such as transaction fees and an explanation of balance computation methods. Applications and solicitations for charge cards, on the other hand, generally would only be required to disclose the annual fee and a statement that the balance is due and payable upon receipt of the bill.

S. 647 would impose disclosure requirements on applications and solicitations for open-end credit plans offered by banks. As a result, banks, but not other card issuers, would be required to disclose any annual or other periodic fee, any grace period, the amount or method of determining finance charges, the amount of any penalties, any minimum fees or charges, any transaction fees or charges, and any other fees or charges.

B. Information To Be Disclosed.

1. Annual Percentage Rate.

All three of the disclosure bills currently pending in the Senate would require disclosure of the annual percentage rate. Only S. 616, however, specifically addresses the disclosure of variable rates. This bill would require the disclosure of both the means for determining the variable rate and, where more than one rate applies, the range of balances to which each rate is applicable.

MasterCard believes that the disclosure of the annual percentage rate should be required in any new disclosure legislation because the annual percentage rate is a principal term affecting the consumer's selection of a card program.

MasterCard also believes that the disclosure legislation should specifically accommodate variable rates. MasterCard urges the Subcommittee to require issuers of cards with variable rates to disclose that the rate or rates is variable and either the rate or rates as of a specified date or the index from which the rate is determined. The variable rate disclosure requirements recommended by MasterCard will be as helpful, if not more helpful, to the consumer in the context of comparison shopping among card programs than the approach provided for in S. 616.

S. 647, which requires the disclosure of "any annual or other periodic fee," may be interpreted to require disclosure of periodic rates. MasterCard believes that the disclosure legislation should not require disclosure of periodic rates. The disclosure of such rates does not provide significant additional information to consumers when they are given the annual percentage rate, particularly in view of the fact that the annual rate is the product of the periodic rate and the number of periods in the year. Disclosure of periodic rates would unnecessarily complicate the disclosure in connection with applications and solicitations and, accordingly, would be inconsistent with the purpose of the legislation to encourage consumer comparison shopping among card programs.

2. Annual Fee.

Each of the bills currently pending in the Senate would require disclosure of fees or charges of the credit card program. S. 241 would require the disclosure of "any annual or other charge of [sic] fee required to be paid for the use of the credit card." S. 616 would require the disclosure of "[a]ny annual or other fee or charge imposed for the issuance or use of a credit card." S. 647 would require the disclosure of "any annual or other periodic fee," the "amount of any penalties," "any minimum fees or charges," "any transaction fees or charges," and "any other fees or charges."

MasterCard supports the required disclosure of the annual or periodic membership or participation fees that may be imposed for the availability of the card account. MasterCard believes that the amount of any annual fee is a principal term affecting the consumer's selection of a card program.

As discussed above, the three bills currently pending before the Senate appear to require disclosure of fees or charges other than the annual or periodic membership or participation fees that may be imposed for the availability of the card account. Although it is not clear under S. 241 and S. 616

precisely what is required to be disclosed, these bills could, for example, be interpreted as requiring disclosure of all charges which may result from the use of the account, including all finance charges, late charges or over-limit fees. S. 647 appears by its language to require disclosure of all such fees and charges.

MasterCard strongly opposes requiring disclosure of any fees or charges other than the annual or periodic membership or participation fees that may be imposed for the availability of the card account. Charges which may result from the use of the account are currently disclosed to consumers prior to becoming obligated under the card plan. pursuant to Section 127 of the Truth in Lending Act. Moreover, requiring such terms to be disclosed in applications or solicitations would make the disclosures more complex and overwhelming for the consumer and would make it far less likely that the consumer would use such disclosures to compare different card programs.

Furthermore, these bills could be interpreted to require disclosure of transaction charges for cash advances. Disclosure of such charges will, in particular instances, be quite complex. For example, many card issuers have varying transaction charges based on whether an advance is a cash advance, a loan advance or an overdraft advance. Moreover, cash advance transactions represent less than 5% of all credit card transactions. This is simply not the type of essential information that should be provided to consumers to facilitate early comparison shopping among different card programs. In any event, this information is included in the initial disclosure pursuant to Section 127 of the Truth in Lending Act.

3. Grace Periods.

All three bills currently pending in the Senate would require disclosures concerning the time periods, if any, within which credit can be repaid without incurring finance charges. Both S. 241 and S. 616 would require card issuers to disclose the time period within which credit can be repaid without incurring finance charges. S. 647 would require disclosure of "any grace period within which an extension of credit may be repaid without a finance charge."

MasterCard believes that any resulting legislation should require disclosure, in connection with applications and solicitations, of the existence or lack of a grace period regarding purchases of goods and services. In this regard, a simple statement that "there is" or "there is not" a grace period should suffice. A complete description of the grace period would require a detailed explanation of such features as the forgiveness periods currently permitted under federal law to accommodate mail delays and any distinctions for purchases and cash advance transactions. Such a detailed description would be

inconsistent with the purpose of the legislation to provide summary information concerning principal terms to facilitate comparison shopping among card plans.

MasterCard also believes that required disclosures concerning grace periods should be limited to purchase transactions. Purchase transactions are, by far, the most common credit card transaction. In addition, grace periods are much more likely to be provided on purchase transactions than cash advances. Since cash advances represent such a small percentage of credit card transactions, a statement of the card issuer's grace period policy with respect to cash advances is not significant comparison shopping information to most consumers considering card programs. Accordingly, inclusion of information concerning grace periods for cash advances would unnecessarily complicate the disclosure and run contrary to the legislation's policy of providing summary information concerning key card plan terms.

4. Manner Of Disclosure.

S. 616 would require card issuers to provide disclosure information in a tabular format. Neither S. 241 nor S. 647 addresses the form of the required disclosures; presumably, under these proposals, the "clear and conspicuous" standard established by Congress for the existing Truth in Lending Act would apply. S. 241, S. 616 and S. 647 are all silent on whether the requisite disclosures may accompany, rather than be a part of, the application.

MasterCard opposes the tabular format requirement of S. 616. As discussed above, the tabular formatting requirement of S. 616 could lead to protracted and costly litigation and liability for card issuers due to technical formatting violations. This is precisely the problem that motivated Congress in 1980 to generally replace the technical requirements concerning the manner of disclosure in the Truth in Lending Act with the clear and conspicuous standard discussed above. Statutorily prescribed tables are restrictive, do not add to consumer understanding, place unnecessary constraints on creditors, impede the ability of card issuers to provide additional information, invite technical litigation, and ultimately prove more costly to consumers.

MasterCard believes that any credit card disclosure bill should make it clear that card issuers can provide required disclosures on the application itself, or otherwise include such disclosures with the application. The consumer would benefit equally from the disclosures, regardless of whether they are provided on the application or accompany the application. Any requirement that disclosures actually be printed on the applications themselves would greatly increase the costs of producing such applications, particularly for relatively smaller card

issuers, in view of the volume discounts that would be lost. Such a requirement could, for example, preclude card issuers from (1) printing applications in large quantities since any change in the terms would force the card issuer to discard its remaining application supply, (2) using the same form for other lending purposes, which is frequently the case, and (3) producing application forms jointly with other card issuers or buying standard application forms.

C. Scope Of Disclosure Proposals.

1. Applications And Solicitations Subject To Disclosure Requirements.

All three of the proposals currently pending before the Senate would require disclosures on every application or solicitation for a credit card account, whether mailed to a consumer, made available at merchant or branch locations ("take-one" applications) or included in catalogs or magazine advertisements. Moreover, S. 616 also would impose additional requirements on "take-one" applications. First, the bill would require that "take-one" applications include disclosure of the "date on which the application is prepared for distribution to a commercial retail establishment." Second, the bill would require that information on "take-one" applications be "accurate as of the date the applications are distributed to the commercial retail establishments."

MasterCard strongly believes that any additional disclosure provisions should apply only to applications and solicitations mailed directly to consumers. Credit card terms can change frequently and it would be difficult, if not impossible, for card issuers to keep current applications at merchant and other public locations. Even if such applications are dated and consumers are instructed to request current terms, consumers might very well rely on the outdated terms printed on the applications themselves.

Moreover, if the disclosure requirements covered applications available at public locations or printed in magazine advertisements, card issuers with programs having different terms applicable to card holders residing in different states could be required to include lengthy schedules of information in such applications, which would be inconsistent with the legislative goal of simplified disclosure of principal terms to maximize consumer comparison shopping. In addition, there simply has not been the same level of concern regarding such applications and solicitations as compared to applications and solicitations, mailed directly to the consumer.

Furthermore, the dating requirements that would be applicable to "take-one" applications under S. 616 would greatly increase the cost of printing such applications, particularly for

relatively small card issuers, because of the loss of the volume printing discounts discussed above. Moreover, the requirement that information on "take-one" applications be accurate as of the date the applications are distributed to the commercial retail establishments could be impossible to satisfy since card issuers frequently use third parties to distribute "take-one" applications, and generally will not know the exact timing of such distributions.

In view of the foregoing, MasterCard believes that the disclosure legislation should not apply to applications and solicitations not directed to particular consumers. If "take-one" applications are to be covered at all, the card issuer should only be required to provide an address or phone number where consumers can obtain the required disclosures.

2. Card Issuers Covered By Disclosure Requirements.

None of the bills currently pending in the Senate applies equally to all charge card and credit card accounts. S. 241 applies only to applications and solicitations for credit card accounts. S. 616 would require issuers of charge cards -- even, in some circumstances, charge cards providing access to extensions of credit under open-end consumer credit plans -- to comply with substantially fewer disclosure requirements as compared to issuers of credit cards. S. 647 applies only to open-end consumer credit plans offered by banks.

MasterCard believes it is essential that disclosure requirements apply equally to all charge card and credit card accounts. Credit cards issued by non-bank issuers, such as retailer credit cards, and travel and entertainment cards which offer a related standby line of credit are functionally equivalent to, and compete fully with, credit cards issued by banks. Even charge cards without a standby credit feature compete directly with bank-issued credit cards for customers who generally pay in full each month.

Currently, bank credit cards make up less than 20% of all cards issued. It is wholly inconsistent with the purposes of the disclosure legislation to deprive consumers of comparison shopping information concerning 80% of the card market. Failure to treat issuers of all charge cards and credit cards equally is also unfair to the card issuers subject to the greater disclosure requirements, who must compete with the other card plans.

D. Other Provisions.

1. Federal Preemption.

Of the bills currently pending before the Senate, only S. 616 addresses the issue of federal preemption. In this

regard, S. 616 provides that state law is not preempted if "the law of the State explicitly requires the disclosure of such information in a credit card application or solicitation."

MasterCard believes that the disclosure legislation should explicitly and completely preempt state disclosure requirements addressing this subject area. Consumers will be able to effectively shop among available cards only if all card issuers, wherever located, are subject to the same disclosure requirements. Moreover, disclosure compliance will be unduly complicated and costly for interstate card issuers if they are forced to comply with differing federal and state disclosure requirements.

The preemption provision of S. 616 above is simply ineffective. This preemption provision would preempt virtually nothing because any state law imposing disclosure requirements on credit card applications or solicitations likely would satisfy the vague and minimal exemption from preemption provided in S. 616.

2. Truth In Lending Act Amendment.

All three bills currently pending in the Senate would amend Section 127 of the Truth in Lending Act, which establishes the comprehensive initial disclosure requirements for open-end credit accounts.

MasterCard believes that the disclosure legislation should amend Section 143 of the Truth in Lending Act. The disclosure legislation fits more naturally with Section 143, which concerns advertising and already encompasses special forms of advertising, such as catalogs. Moreover, the legislation should provide that the required disclosures would not trigger additional disclosure requirements under Section 143 and applicable Federal Reserve regulations. This can most easily be done through disclosure legislation that amends Section 143 rather than Section 127.

3. Effective Date.

S. 647 would provide an effective date of January 1, 1988. S. 241 provides no specific effective date, and thus presumably would be effective on enactment. S. 616 would require card issuers to be in full compliance with the resulting Federal Reserve Board regulations within 90 days of the effective date of such regulations, and would require the Federal Reserve Board to issue regulations in final form within 90 days of the enactment of the law.

As discussed above, MasterCard believes that card issuers will need at least six months after final promulgation of Federal Reserve regulations to comply with the new disclosure

requirements. In this regard, card issuers must take such steps as developing and printing new forms and collecting and destroying old forms, which can only commence after the Federal Reserve has promulgated its final regulations.

III. Credit Card Interest Rate Limitations.

MasterCard strongly opposes any effort to artificially limit interest rates.

Such legislation is unnecessary and would result in a misallocation of resources given the vigorous competition in the credit card market. No single supplier dominates the market. Competition has caused, and continues to cause, reductions in credit card rates.

The fact that credit card rates are above the current cost of funds is not inconsistent with a competitive market for credit cards and does not necessarily mean that card issuers are making "abnormal" profits. Credit card programs are far more costly to administer than other consumer credit programs. The fixed costs of establishing and maintaining a credit card payment system are enormous. Credit advances, virtually each of which involves sales slips and authorizations, cost more to administer than other consumer loans. The initial and ongoing disclosures, monthly billing statements, and responses to cardholder inquiries mandated by federal law further increase costs. Losses due to bankruptcy, fraud and bad debts are higher for credit card loans than for many other forms of credit because credit card loans are unsecured. For all these reasons, the cost of funds in a credit card program represents less than 40% of the cost of a credit card transaction.

Moreover, the actual finance charges paid by the customer is often substantially less than the stated credit card interest rate. The one-month, interest-free grace period offered by most card issuers for purchase transactions results in an effective interest rate significantly lower than the stated rate. The effective interest rate is reduced further to the extent the customer pays his or her balance in less than 12 months. Indeed, the effective interest rate for "convenience" customers who pay their monthly bills in full within the grace period, which the Federal Reserve has found comprise 47% of all credit card customers, is zero.

The steady growth of credit card purchases as a percentage of personal consumption over the past few years suggests that consumers believe that interest rates charged on credit cards are reasonable relative to the other credit alternatives generally available. Credit cards also provide otherwise unobtainable access to traditional sources of credit for many young and low-income consumers.

verify, first of all, that it is the card member using the card for that purchase and that it's not a stolen card. We might ask certain questions of the card member to verify that it is the card member and that everything is OK, in terms of that purchase. We might also make an inquiry to their bank, if we had reason to suspect that they may not be able to handle that large of an out-of-pattern purchase. We would want to make sure that they were solid and that they would be able to pay for that purchase when the 30-day statement comes due.

Senator DODD. Now can you get a hold of that bank account number from the bank without the bank or the cardholder's permission or their authorization?

Ms. FERNSTROM. We would have that reference in the application that the card member had filled out for their American Express card. They would have listed their banking reference, which we would be able to contact.

Senator DODD. So you could contact that bank and check that account without the cardholder's permission or their authorization?

Ms. FERNSTROM. No, we would ask the card member at that point or indicate to them that we needed to check with their banking records to make that verification.

Senator DODD. Well, the reason I ask you that, and I appreciate your response, is because we received, in fact, a letter which states that American Express not only asked for a man's account number without the authorization and permission, but an American Express employee, and I quote them here, and we asked about this, said "Most banks have good relations with American Express and will divulge an account balance without a letter from the account holder."

Ms. FERNSTROM. I am not aware of that situation, but I would be happy to look into it and get back to the committee on it.

Senator DODD. Well, I would, because that is disturbing to me. I understand and appreciate the position of American Express. Obviously, $7,000 from $1,000 is an unusual transaction, and you want to check that out, I think, certainly, to check whether or not the consumer made it. But the idea that you could get into that bank account without authorization of the cardholder and that banks would allow you to have access to that is highly disturbing to me. And I would like to know whether or not that is the bank practice and whether or not that employee from American Express stated the position of American Express accurately.

Ms. FERNSTROM. Right. I will be happy to look into it.

Senator DODD. Senator Sasser.

Senator SASSER. Thank you. Thank you very much.

Mr. Wiesler, referring to the letter that the Chairman was questioning you about a moment ago written by Mr. Russell, the president of VISA U.S., I note in the third paragraph, and I quote, he said "I'm alerting you of this development"—talking about the Optimum—is that the way you pronounce, it, Ms. Fernstrom, Optima?

Ms. FERNSTROM. Optima.

Senator SASSER. Optima.—the Optima card being issued by American Express. He says:

I'm alerting you of this development because, in my view, the Optima credit card service will have far greater effect in the long run upon your bank's profits than will the much publicized Discover card, which was recently launched by Sears, Roebuck & Company.

Now the Discover card launched by Sears, Roebuck charges a 19 percent interest rate, if I am not mistaken, and the Optima card charges only a 13.5 percent rate of interest. Is that what you think Mr. Russell had in mind when he said in the long run this Optima card poses a much larger threat to your profits than the Discover card?

Mr. WIESLER. Yes, what I think what he was trying to point out here that American Express with this new product, would probably be a tougher competitor than Sears. Sears' problem has been that they found it very difficult to sign up merchants and get a merchant base, because of the fact that the retailers view Sears as a tremendous competitor, and therefore, their product has been as successful as many of their competitor credit card operators thought that they would be. So here is an opportunity that American Express has come in, and this did not come as a surprise to VISA or I am sure, MasterCard, because we knew almost a year in advance that this was in the planning stage, that someday it would come to fruition.

OPTIMA CARD IS A THREAT TO VISA

Senator SASSER. Well, my point is—the point I was making was perhaps Optima proposes a great threat to VISA, because the interest rate on the Optima card is 5½ percent less than on the Discover card, and if I were choosing, I would certainly choose the Optima card over the Discover card, because I would pay less interest, and I would be paying less interest with Optima than I would be paying for my VISA card. And I surmise that that was probably the reason that Mr. Russell says that Optima poses a greater threat than the Discover card. I am looking here at a VISA bill, and I see on this VISA bill, it says $750 or less, monthly periodic rate, 21 percent. Over $750, monthly periodic rate, 15 percent. This bank with a 21-percent interest rate VISA card will have a hard time against a 13.5-percent Optima card. It looks to me like, if the consumer knows what he is doing, you wouldn't be able to compete. I have a hunch that is what Mr. Russell may have been referring to.

Mr. WIESLER. Well, as Ms. Fernstrom said, they very much have market-segmented their group. It is a very up scale market that they are going after, and that part of the market is one that VISA is simply going to have to take a very good look at, at least the issuer, because obviously, those that have an American Express card that are going to use a credit balance, will be those that probably already now have a MasterCard or a VISA card, and obviously, that is the—those people are then going to have a choice.

Senator SASSER. So what you've got there—in essence, what you've got with the new Optima card, you've got the market really beginning to work. I don't understand why Mr. Russell urged his bank customers to cease doing business with American Express, in response to the announcement of the 13.5 percent Optima card. Why didn't VISA simply advise these banks to meet the lower in-

terest rate competition. Suggest they meet it head on. That's what a free market is all about. Why didn't they do that rather than threatening American Express.

Mr. WIESLER. Well, I suppose that he was a little stunned by the fact that he felt that the 13.5 percent was a little bit misleading, because, in effect, to get 13.5 percent, you have to pay $60 as the minimum on the annual fee, and if a person had an average of $1,000 outstanding, then that would equate to 18 percent as opposed to the 13.5 percent.

Senator SASSER. Well, maybe he would have been better advised——

Mr. WIESLER. So there was a very good bit of merchandising, and I think he wanted to respond to that.

Senator SASSER. Maybe he would have been better advised to spend some of the money that's spent on advertising to advertise the differences between these two cards, and the fact that American Express' 13.5 percent was a misleading rate of interest, if that's the way VISA viewed it. I am, just frankly, appalled that such a letter could go out, quite frankly, and I think it's very tough to explain.

Mr. Silberstein, you indicated that MasterCard is opposed to caps on bank cards, that you are also opposed, I believe, to the chairman's disclosure legislation, if I'm not mistaken.

Now how would MasterCard react then to the Congress just saying we are going to wash our hands of this whole thing, and what we are going to do is just do one thing, and that's repeal the *Marquette* case and let the states then determine how to deal with the problem of bank credit cards.

Mr. SILBERSTEIN. I think MasterCard's position would be that such an approach would run contrary to the objectives of the legislation being considered here today, which is to enhance competition in the marketplace and to make a maximum amount of credit available to qualified consumers by a wide variety of competitors who would be competing on the basis of credit availability, rate and other prices and differences in service level.

Senator SASSER. So MasterCard's position is, we just want the status quo. We don't want any cap, we don't want any additional disclosure, we don't want any repeal of the *Marquette* case, so that the States can exercise their traditional sovereignty over interest rates. We like it just the way it is. And I don't blame you.

Mr. SILBERSTEIN. We have stated our support for disclosure. We believe that disclosure at the point of credit solicitation can help a consumer shop intelligently. However, we urge that the disclosure requirements be kept straightforward and simple, so that the consumer will, in fact use the information to make intelligent consumer shopping decisions.

FOUR AREAS OF DISCLOSURE

We believe that only four principal terms really need to be disclosed—the annual percentage rate, the annual fee, whether or not there is a grace period, and finally, where there's a variable rate, an indication that it is, in fact, variable and how it is determined. We would support legislation providing for such disclosure.

Senator SASSER. All right. Thank you, gentlemen. Thank you, Ms. Fernstrom. Thank you, Mr. Chairman.

Senator DODD. Thank you. Let me pick up on that last point. You object to the idea of detailing what a grace period would be, because I think in your statement you said it would be a little complicated. Is that true?

Mr. SILBERSTEIN. The concern is with overcomplicating the description.

Senator DODD. Well, let me show you what First Atlanta does in their First Atlanta card. They go down and they list here with this solicitation. Thirty-day grace period. How complicated is that? That's not complicated. Is that complicated, to your mind?

Mr. SILBERSTEIN. As a manager who has had to translate that kind of requirement to the arcane details of computer programming that results in the exact result, I wouldn't want to be pressed to either ask the details of precisely what a 30-day grace period means or explain them.

Senator DODD. "No finance charge will be assessed on purchases when you pay your balance in full each month. Thirty-day grace period." That is pretty clear.

Do you object to that, Mr. Wiesler? Is that complicated?

Mr. WIESLER. No, that isn't complicated. I think you can make it a little more flexible than that, because different months have different numbers of days in it, and the complexity of the computer systems in many banks are such that it creates a lot of expenses.

Senator DODD. It says 30-day. I mean, one of the points is—you know, one of the problems we have is that a grace period—you say, well, we have a grace period. You've got a grace period. All three of you have got a grace period. You've got 30 days; you've got 10 days, and you've got 1 day. How is the consumer well-informed on that, if you don't spell out what it is. They're all grace periods.

Mr. WIESLER. I think you can have a minimum grace period.

Senator DODD. Well, that's what I suggested. If I said 30 days. If we defined a grace period as a minimum being 30 days. And then we list grace period.

Mr. SILBERSTEIN. Many of our members which have grace periods that work very effectively on behalf of consumers have grace periods as short as 21 days and as long as 30.

Senator DODD. What number would you accept as a minimum?

Mr. Silberstein. I think as an industry 21 days would probably be acceptable.

Senator DODD. Twenty-one.

Mr. WIESLER. It would avoid——

Senator DODD. Well, that helps.

Now let me ask you something. I appreciate the difference between the charge card and the credit card debate and so forth. I would agree with my colleague from Tennessee. I don't know who is giving good advice, but that letter was a dumb move. I mean, that is not the way to deal with that issue. I don't know why he would bring on that kind of thing to the company, but here's what sticks in the craw.

Four of the six credit card companies, three of you are sitting here, issue, basically, one-quarter of the 186 million credit cards that are out there in the country. That is the lion's share of the

market, right there, sitting at this witness table today. And when you've got four of the six that have charged the same rate for 5 years, how do you explain that?

Mr. WIESLER. I don't think that's right. VISA's is made up of 4,000——

Senator DODD. Excuse me. The same rate today as they were 5 years ago. Put it that way. There's been no change. The rates may differ a little bit, but basically the same rates. And things have changed out, the cost of money——

Mr. WIESLER. If you look at it individually and examine it, there are many rates that have gone down over that period of time, many rates. There are some rates that have come up, and the rates that have come up have come up because States have eliminated the usury rates for those States. So it is a little misleading to look at the average balance, I think. The trend is clearly now that rates are coming down, and I think the marketplace is the best determination, and when the consumers get to the point where they are better informed, and that is why we are for disclosure, they will begin to have something to say about it, and they will go where they get a better deal. And I think, to put an interest rate cap on——

Senator DODD. I'm not arguing the cap. We're not talking about the cap. The problem you have, and I suspect one of the reasons you haven't seen the kind of revolution that you get in one of these things is because if a consumer has $1,000 outstanding in credit, the monthly charge that comes with that invoice is about $15, and so the $15 doesn't seem like a great deal, in terms of $1,000—they are not thinking about it in terms of an annual rate, in that sense. So it just doesn't seem like that much.

Do you agree with that? Do you think that's probably the reason?

Ms. FERNSTROM. I think there is a comparison that can be made, perhaps, to another area of regulation, and that is nutrition labeling on food. Before consumers knew what was in the food, they didn't have quite as much sensitivity to the amount of carbohydrates or protein or even calories, but now that we do see nutrition labeling on more and more items, consumers are much more sensitive to it, and they make choices based on that information. And I agree completely with what you said, Mr. Chairman, that as consumers see this information provided on a regular basis and in a uniform format, they become much more sensitive to looking at it and making their decisions based on it.

Senator DODD. Anybody else want to comment on that?

Mr. SILBERSTEIN. The only point I would reiterate is that the basis for the seeming indifference of some consumers to interest rates is, that they don't ever pay any interest. For, many consumers, the interest rate is zero.

Senator DODD. I'm sorry. You've got to get closer to that microphone. I can't hear you.

Mr. SILBERSTEIN. I'm saying that for many of the consumers who pay their balance in full each month, the interest rate is not really relevant at all, and their attention is perhaps focused on the other services, the annual fee, the quality of service and, of course, the extension of credit itself.

The most important consideration in why credit card interest rates have not responded as quickly as some of the other bank lending rates in a bank is very simply that the expenses involved in supporting a credit card program go well beyond lending and go well beyond the cost of funds. It is a very expensive, very intricate service that is being provided, with the cost of funds being only a minor portion of the cost of that service.

Senator DODD. But you are not going to disagree with me that it is, as of late, anyway, generally the most profitable, one of the most profitable features of a bank's activities?

Mr. SILBERSTEIN. I would say that it's not necessarily the most profitable activity in a bank.

Senator DODD. Well, I understand not necessarily in every case, but generally?

Mr. SILBERSTEIN. My understanding is that credit cards are profitable in most banks today. It is not the most profitable service being offered.

Senator DODD. Well. The insurance cost on stolen or lost cards, no one has ever—have any of you ever charged a $50 feet for a lost or stolen credit card? Do you know of any?

Ms. FERNSTROM. I'm not sure if we have or not. I think it is generally a practice that we don't, as a matter of good will for the customer.

REGISTRY SERVICE

Senator DODD. How do you justify the insurance, if that's the case?

Ms. FERNSTROM. Are you referring to the registry service of having the card numbers registered with a company?

Senator DODD. Yes.

Ms. FERNSTROM. We've found that consumers were very interested in that service, primarily as a matter of convenience, so that if they did lose their wallet or purse, and all of their important documents were lost or stolen, they could make one phone call to our company, and we would immediately notify all of their other creditors and initiate the process for them of getting replacement cards. So it is very much a service and a convenience to the card member.

Senator DODD. Well, but there's a cost associated with that, isn't there?

Ms. FERNSTROM. There's an annual fee for that extra service; yes.

Senator DODD. And my point is, if you don't ever really charge anybody for it—I understand it is a very nice service, but I don't understand—you're never going to charge anybody for those kind of things, what's the point?

Ms. FERNSTROM. Well, I think, as Governor Seger pointed out earlier, it is a cost of doing business, and while we may not charge back the individual card member, we do incorporate those losses into the total cost of doing business.

Senator DODD. Well, maybe it would be better to identify it accordingly, and I think there is a misconception there, you're dealing with insurance.

I should have asked the two of you about the question of an individual, where there is an unusual activity. Do both of your compa-

nies follow the same practice as American Express and that is, have access to accounts without permission of the cardholder?

Mr. SILBERSTEIN. The general practice among MasterCard and VISA banks, although each bank really makes its own decision about how to issue credit, what rules it will work under, is that the credit decision is made up front, at the time at which the card is applied for, or later if the cardholder applies for a larger credit line. And typically, other than verifying the identity of the cardholder in a suspect transaction, that is verifying that the consumer is, indeed, the legitimate cardholder, no action will be taken to, at that point, at any bank that I know of, to verify the capability of the consumer to pay their bill at that instant. Their credit line has been established, and as long as their spending is within that credit line, they have the ability to borrow.

Senator DODD. If it went beyond the credit line?

Mr. SILBERSTEIN. That typically is not allowed.

Mr. WIESLER. That is right. That would be the same in Bank of America. In most VISA banks that I know about, the main caution that you look for is stolen, fraudulent credit cards. To protect the individual cardholder, we do have elaborate precautions to catch that type of out-of-pattern spending. Other than that, as far as the borrower going over his credit limit, there's a little flexibility, if they just go slightly over, there is no concern.

Senator DODD. But again—I think you have answered the question, but for purposes of clarity, what you are telling me in both of your cases is that your companies do not seek access to a cardholder's account without the permission of the cardholder?

Mr. SILBERSTEIN. That's right in our case; that's correct.

Mr. WIESLER. That's true.

Senator DODD. Senator Sasser, I think, has left. Do any of you have any additional comments you would like to make at all, before I excuse you? I appreciate your being here this morning. We may have additional questions from people, and I appreciate your willingness to respond to those in writing, when they come up.

As I announced earlier, what I want to do here now, since I have kept everyone a little bit late is, we will recess the hearing until 2:20 p.m., at which time I will call our last panel. And my apologies to them for this going longer than we had anticipated.

Again, I thank all three of the witnesses from the companies being here.

We will stand in recess until 2:20.

[Whereupon, at 1:20 p.m., the hearing was recessed, to reconvene at 2:20 p.m., this same day.]

AFTERNOON SESSION

Senator DODD. The Subcommittee on Consumer Affairs of the Senate Banking Committee will come to order.

I appreciate the patience of our last four witnesses, panel 3 and Mr. Kizer. Our hopes had been, of course, to be able to have you on this morning, but as I believe I saw all three of you patiently sitting in the committee room, it went on a bit longer. In fact, we had more participaton by members of the subcommittee and even those

who are not members of the subcommittee and those who are not even members of the Banking Committee—[laughter].

Senator DODD [continuing]. Show up here this morning with an interest in the legislation. That is to be applauded. When we get that kind participation, I think we have more productive hearings, when people take an interest. I think we all benefit from the questions and comments of other Members of the Senate on a matter such as this. So I hope this has not caused it to be too much of an inconvenience for the three of you here.

I will introduce the three of you. Jerry Craft is the senior vice president of the First National Bank of Atlanta, representing the American Bankers Association. Michael Zoroya—did I pronounce that correctly?

Mr. ZOROYA. Perfectly.

Senator DODD. Perfect. It's my Spanish training, that does that. [Laughter.] Who is a Retail Services Consultant, the May Department Store Co., representing the National Retail Merchants Association, and Mr. Ralph Rohner, who is the Special Counsel to Consumer Bankers of America. He is the Dean of the Columbus Law School, Catholic University, representing the Consumer Bankers of America. I thank all three of you for being here. You heard me earlier say that we try and keep your statements relatively brief, if we can, highlight the major points. Of course, your full statements will be made a part of today's hearing record.

Why don't we begin with you, Mr. Craft, since I introduced you in that order, and express your views on these three bills.

STATEMENT OF JERRY D. CRAFT, SENIOR VICE PRESIDENT, REPRESENTING THE FIRST NATIONAL BANK OF ATLANTA AND THE AMERICAN BANKERS ASSOCIATION

Mr. CRAFT. Thank you, Senator Dodd. I do represent First Atlanta and the ABA today. We are very delighted to be here to testify before you, and I want to make my comments brief.

We support disclosures, if they are simple and useful to consumers. The consumer needs the ability to make the appropriate choices.

Second, we support disclosure, if it promotes competition and encourages the marketplace to function efficiently.

Third, if it is equal for all competitors and equivalent products. Consumers don't distinguish between charge cards and credit cards. If it is limited to mail solicitations, allows reasonable time for implementation and preempts State disclosure laws.

We oppose ceilings at Federal or State levels under any scenarios we have seen. First and foremost, credit cards are a payments device providing convenience and secondarily, credit. The average consumer uses his card 30 times a year to make 50 loans around the world in the local currency.

Second, variable rates forces the consumer to take the interest rate risk. Historically, banks have accepted both the credit and the interest rate risk. What looks very efficient today with a new product at 1.7 times prime, in 1981, as Senator Shelby's chart would show, 1.7 times prime in 1981 would be in excess of 30 percent and not very competitive.

Third, ceilings would cause a restructure of pricing to consumers, perhaps without grace periods and annual fees closer to T&E cards.

Fourth, ceilings would reduce competition and reduce the ability of banks to offer different products to different market segments, segments that should be served with different rates.

Fifth, price controls have not worked in the past.

Sixth, a restriction of credit will occur to those who need credit the most.

Seventh, the marketplace can and will do a better job and be self-correcting in the future.

I would like to make two additional points. One, earlier on our recent promotion in a 30-day grace period that we use in our disclosures, the grace period is over a year, 30.4 days, but from February 15 to March 15, is only 28 days. If it is from March 15 to April 15, it is 31 days. Again, if the 15th in one of those months falls on a weekend or a 3-day holiday, you can get variations of 5 days. So we really provide from 27 to 33 days, but on average, just over 30 days throughout a full calendar year.

The last point I would make on Senator Shelby's chart is that the rate for credit cards up there ranges at the 18 percent pretty much throughout the time period. The true yields that banks receive on the credit card because of providing a free period is much closer to 15 percent.

In many of the analyses made, it is assumed that banks were making a profit and that reduction in the cost of funds is all profit. Most of the reduction in the cost of funds reduced losses banks were sustaining in 1981.

I have no more verbal comments but would be pleased to answer questions at the end of the testimony.

[Complete prepared statement of Mr. Craft follows:]

Testimony of the American Bankers Association
Before the
Subcommittee on Financial Institutions and Consumer Affairs
Committee on Banking, Housing, and Urban Affairs
On S.241, S.616, S.242, S.647
Legislation on Credit Card Disclosures and
Credit Card Interest Rate Limitations

March 26, 1987

Mr. Chairman, members of the Subcommittee, I am Jerry Craft, Senior Vice President of the First National Bank of Atlanta and Chairman of the Retail Electronic Services and Bank Card Division of the American Bankers Association. I am pleased to be here today to discuss proposed legislation regarding disclosures for credit card solicitations and applications, and limits on the rate of interest to be charged on credit card accounts. The Association appreciates the opportunity to discuss these matters with the Subcommittee.

DISCLOSURE BILLS

The bills (S.241, S.242, S.616, and S.647) introduced respectively by Senators D'Amato, D'Amato, Dodd, and Sasser, seek to improve the timeliness of disclosures of credit card account features and provide consumers with "more detailed" and "uniform" disclosures of terms and costs associated with credit card accounts. S.647 and S.242 also set limits on credit card interest rates.

We support the intent of this legislation insofar as the bills would make available to the consumer crucial information needed for an informed decision in selecting credit or charge card services.

Mr. Chairman, we would first like to note that there is already legislated comprehensive disclosure of important information regarding credit card accounts under Truth-in-Lending. As required by that statute, creditors must provide: a statement of when finance charges start to accrue; the annual percentage rate (APR); an explanation of the method used to determine the balance on which a finance charge may be imposed; the method of determining the amount of the finance charge; identification of all other charges; and other information relating to security interests and billing rights.

This information required by Truth-in-Lending must be received before the first transaction is made. Ordinarily, the disclosures are received with, or prior to the receipt of the card. Thus, consumers may still decide to keep or reject the card, based on evaluation of information available when they receive the card. A consumer is not obligated to the card until the complete terms of the contract are received. In addition, a comprehensive range of disclosures is provided to the customer with each statement.

Nevertheless, in the interest of enabling consumers to compare credit card accounts and to make informed choices, we support legislation that assures reasonable disclosure of pertinent features of credit and charge card accounts on solicitations. We must stress, however, that any new disclosures should be meaningful, easily understood, and useful for the purposes of choosing a card. In this regard, we believe that disclosure of: 1) the APR; 2) any annual fee or other membership or participation fee for the availability of the account; 3) and the availability of a grace period are the crucial features influencing a consumer's choice of credit card services. Disclosures should be limited to these elements. The simpler the disclosure, the more likely that it will be used by the consumer when evaluating the credit card account. In addition, disclosure requirements should be limited to mailed solicitations and should exclude the broader area of "take-one" applications that are usually found in retail establishments and available to the public in general. The legislation should apply also to charge cards, particularly those that offer an open-end credit feature. Finally, the bill should allow federal law to supercede state law related to disclosures on credit card and charge card applications.

Based on these principles, we believe that the bills under discussion today require simplification to assure that the consumer will receive understandable and pertinent information on which an intelligent credit decision can be made.

In their current form, the provisions of S.241, S.616, and S.647 will create a cumbersome and confusing list of disclosures that will hinder and even discourage effective comparisons while imposing unacceptable burdens on card issuers. For example, the provisions of S.647 require disclosure of a seemingly endless list of potential, although infrequent, charges; S.241, S.616, and S.647 require disclosure of a narrative explanation of the length of the grace period for both purchase and cash advances; S.616 mandates disclosure of a statement explaining how the card issuer determines the balance on which the finance charge is computed. Extensive explanations and lists do not enhance a disclosure that is intended to be brief and readable.

We also strongly oppose inclusion of take-ones in the legislation. Compliance would be burdensome and the information which can become obsolete after a short period, will mislead or confuse rather than inform the consumer.

Annual Fees and Other Charges

Throughout this discussion, we should make a distinction, on the one hand, between providing sufficient information in a promotional mailing for a potential customer to make a choice and, on the other hand, numbing the customer's comprehension with a bewildering and often discouraging, legal brief of disclosures. When disclosures become too lengthy or difficult to understand, consumers ignore them, ultimately defeating the purpose of providing them.

For example, any requirement to disclose annual fees and similar fees associated with membership should be worded so that the requirement will not be interpreted to include the list of charges for abusive and abnormal use of the card product: late payments, bad checks, card replacements, over-limits. Such exceptional and nonrecurring handling charges should not be included in promotional mailings.

The promotional mailing should contain pricing information for the normal use of the product, like annual fees and annual percentage rates. Consumers do not anticipate that they will habitually pay their bills late, so a late payment charge is not a critical element in choosing the card. Rather, consumers look to features which will be applied consistently to the account, that is, annual fee, grace period, APR.

The language used in S.241, S.242, and S.616 present problems in that all of them could unnecessarily lengthen the disclosures without offering particularly useful language to consumers. S.241 requires disclosure of "any annual or other fee required to be paid for the use of the credit card account." S.616 and S.242 use similar language, "[A]ny annual or other fee or charge imposed for the issuance or use of a credit card," and "any annual or other fee imposed for the issuance or use of that credit card." The words "fee ...for ...use of a credit card" without guidance as to what they mean, could trigger disclosure of an assortment of peripheral and nonrecurring fees which are little considered when choosing a credit card. The result would be to clutter unnecessarily the disclosures with information that carries little weight with the consumer who is measuring the values of a particular card.

The language of S.647 is most worrisome in this matter. That bill requires not only disclosure of any annual or other periodic fee, but also of the "amount of any penalties; ...any minimum fees or charges; ... any transaction fees or charges." This kind of list should be avoided. The list could amount to a litany of disclosures that either will be ignored by consumers because of its inordinate length or will serve to confound them so that they are not able to choose a card intelligently. The requirements of S.647 will not merely crowd the disclosures; they will overwhelm all readers who endeavor to discern which figures have merit for the purpose of choosing a card.

Grace Periods

Disclosure concerning the "grace period" is a provision common to S.241, S.616, and S.647. We support disclosure of the existence of a grace period for purchases. However, we caution against translating a simple concept into a cumbersome explanation.

Once again, any disclosures should be limited to salient features and should avoid complicated, lengthy explanations that may hinder what is otherwise a convenient disclosure of pertinent features. A simple statement disclosing the availability of the grace period, or lack of it, on purchases should be sufficient for a promotional mailing.

S.241, S.616, and S.647 all require disclosure of the length of any period within which balances must be repaid to avoid finance charges. At first blush, this appears to be a manageable requirement. However, because the length of the period may vary given the number of business days each month, the bills' requirements may only be satisfied by a lengthy narrative description. This defeats the purpose of the disclosures. The complexities of how the grace period works can be found in the subsequent Truth-in-Lending disclosures issued before the card is used and again in every statement mailing.

A second recommendation in reference to this requirement concerns the disclosure of the length of the grace period for both purchases and cash advances. Requiring disclosure of the length of the grace period for both types of use compounds the "information overload" problem already created by the length of grace period disclosures. Under all the three bills, not only must the issuer provide the narrative explaining the length of the grace period for purchases, but must repeat this exercise for cash advances. Since few card issuers provide a grace period on cash advances and since they represent a very small and decreasing percentage of credit card transactions, this information is of limited value to the consumer when comparing credit cards, yet greatly increases the length of the disclosures. We suggest that grace period disclosures be limited to those associated with purchases.

Disclosure of Balance Determination

S.616, requires creditors to disclose, in addition to the APR, annual or other fee for the issuance or use of the card, and length of the grace period, a statement of how the creditor determines the balance on which the finance charge is computed. We are convinced that such a disclosure defeats valid efforts to provide meaningful and useful information to the potential customer.

Consumers do not choose a card based on how the card issuer calculates the balance on which the finance charge is assessed. Instead, they decide based on features that are more readily understandable and that have a more significant impact on their costs, such as the APR, annual fee, and whether a grace period is available. Explanation of this balance computation is complex and long and predictably is not easily understood.

Further, comparison shopping among balance computations would rarely be a meaningful exercise for the consumer. Such information is later disclosed as required by Truth-in-Lending prior to the use of the card. It would seem pointless to require disclosure of an item that does not influence the decision process, but, because of length and complexity, may in fact dilute the effect of other more salient disclosures. Moreover, the consumer will receive the information in a timely fashion.

Finally, the method of calculation of the balance, at least among the various average daily balance methods which are commonly used by banks, makes little difference to the total amount of the finance charge.

reduce their costs to the prices permitted by the rate ceiling. Other consumers would substitute other forms of credit which would be more costly than credit card credit (loans from finance companies or local retailers) or less convenient (such as increasing loans on automobiles or houses and carrying larger cash balances).

Mr. Chairman, thank you for letting me present the views of the American Bankers Association on this proposed legislation. I would be glad to answer any questions you may have.

Senator DODD. Thank you very much. Mr. Zoroya.

STATEMENT OF MICHAEL ZOROYA, RETAIL SERVICES CONSULTANT, THE MAY DEPARTMENT STORE CO., REPRESENTING THE NATIONAL RETAIL MERCHANTS ASSOCIATION

Mr. ZOROYA. Thank you, Mr. Chairman.

I'm Mike Zoroya. I am retired senior vice president of credit for the May Department Stores Co. and a consultant to the company. I am also a member of the Federal Reserve Board's Consumer Advisory Council.

On behalf of the National Retail Merchants Association [NRMA] I welcome the opportunity to present the views of retailing on the proposed legislation. Earlier today, we have heard a lot of discussion from the perspective of banking, and I appreciate the opportunity to talk about the retail industry in connection with credit cards.

NRMA's prepared statement sets forth the industry's views in detail. This statement is also endorsed by the American Retail Federation. I am going to try to make my comments extremely brief. They are based on my 34 years spent in credit. I have operated credit departments and dealt with customers for many, many years.

On the issue of rate caps, retailers don't believe that they can be justified on economic grounds. As a rule, retailers' revenues from their credit operations do not exceed their costs. In fact, May Department Stores' credit costs exceeded credit revenue by $79 million in 1986.

I have attached to my oral statement the actual numbers, for May Department Stores to show you how our finance charge revenue does not reach the credit costs.

Incidentally, the costs that are listed on this report—I don't know if you have it in front of you, in attachment A, Senator, but these are direct credit costs. There is no overhead or lights or heat or anything else that is part of our credit expense. These are direct credit costs that are expenses to be offset by the finance charge revenue. And as you can see, in 1986, we had a deficit of $79 million. So most retailers don't make money on credit. Moreover, some people find it surprising to learn that the average finance charge for our customers was only $28.57 per account for the entire year. The average account balance in our company is only $185. We charge no annual fees. We offer 30 to 59 days of free credit. I think it is important to note that about 30 percent of our accounts are paid in full each month. That's not 30 percent of our customers. By that, I mean there are different customers every month that pay their accounts in full. We tested one of our stores, for example, and

we found that 95 percent of our charge customers used revolving credit at least one time in the previous 12 months. So customers use revolving credit in our stores sometimes and they pay in full in 30 days, but about 30 percent of our accounts each month are paid in full.

ATTACHMENT A

THE MAY DEPARTMENT STORES COMPANY
FINANCE CHARGE REVENUES AND CREDIT COSTS
FISCAL 1986
($ in 1,000's)

	$ COSTS	$ INCOME	% TO CREDIT COSTS
FINANCE CHARGE REVENUE		213,910	
CREDIT COSTS:			
ACCOUNT PROCESSING COSTS	14,791		5.7
BAD DEBT EXPENSE	44,905		15.3
DATA PROCESSING, SYSTEMS & EQUIPMENT	10,863		3.7
PAYROLL	51,589		17.6
EMPLOYEE BENEFITS	12,897		4.4
POSTAGE	15,675		5.3
COST OF FINANCING ACCOUNTS RECEIVABLE	142,470		48.6
TOTAL CREDIT COSTS		293,190	100.0
NET CREDIT INCOME/(LOSS)		(79,280)	

	1986	1985	1984
EFFECTIVE FINANCE CHARGE RATE (%)	15.5	15.3	14.7
AVERAGE BALANCE PER ACCOUNT ($)	185	191	177
ANNUAL FINANCE CHARGE PER ACCOUNT ($)	28.57	29.19	25.92

As a result, although our divisions charge nominal rates of 15 to 21.6 percent, our effective rate for the entire company in 1986 was 15.5 percent.

Retailers direct credit costs, as you can see on attachment B include three major factors, administrative costs, bad debt expense and the cost of money. Attachment B is a very important chart, because it shows the actual cost of money for May in the last 10 years. And you can see, starting with 1976, that our average costs of debt ranged from 7.2 up to 10.3, and the average prime rate is shown right beside it. The reason for that is because, as a retailer, we don't borrow money at the prime. We can't get money at 3 months' Treasury notes. We borrow money in the market, and we have to pay the long-term costs of that money. We try to get into the long-term market to avoid fluctuations of the prime rate, and I think our average cost of debt over the last 10 years demonstrates that. So that actually, the cost of funds amounts to 48.6 percent of our total credit costs. It is a substantial part. But our administrative costs of credit are much greater than would be in an organization, for example, that has a huge balance on which a great portion of the income offsets the cost of money, and the administrative cost becomes a small portion of the total costs of operating that account.

ATTACHMENT B

THE MAY DEPARTMENT STORES COMPANY

AVERAGE COST OF DEBT VS. AVERAGE PRIME RATE

1976 - 1986

	AVERAGE COST OF DEBT[a]	AVERAGE PRIME RATE[b]
1986	10.3%	8.3%
1985	10.6	9.9
1984	9.6	12.0
1983	9.4	10.8
1982	9.2	14.9
1981	8.6	18.9
1980	8.5	15.3
1979	7.7	12.7
1978	7.8	9.1
1977	7.7	6.8
1976	7.2	6.8

SAMPLE INCREASES IN OTHER RETAIL CREDIT COSTS

	1976	1986	INCREASE
POSTAGE[c]	.13	.22	69%
MINIMUM WAGE[c]	2.30	3.35	46%
AVG. WKLY. RETAIL EARNINGS[b]	114.60	177.31	55%

a - Source: May Department Stores Corporate Treasury Department
b - Source: Economic Report of the President, February, 1986 and Federal Reserve Board Bulletin, February, 1987
c - Source: Statistical Abstract of the United States

Generally, banks employ some variation of average daily balance system when determining how the finance charge will be assessed. The resulting average daily balance is determined by dividing the sum of the daily balances of a billing period by the number of days in that billing period. Variations occur depending on how the daily balance is calculated.

For instance, some creditors using one method will exclude unpaid previous finance charges from the daily balance. Thus, if no payment is received, the finance charge from that bill is carried forward, but no finance charge is assessed against it. Some creditors exclude from the daily balance any debits from purchases made during the month, while others include them. Variations may also occur depending on whether payments are applied to principal before finance charges, the opposite, or in equal proportion. The only time finance charges vary significantly are when the initial "free period" is eliminated when the cardholder does not pay the balance in full at the end of the month. In these cases, the effect of the finance charge is a function of the use and availability of free periods rather than the average daily balance method employed. In general, however, these variations in average daily balance methods produce little difference in the final average daily balance on which the finance charge is imposed.

Thus, at least for banks using the average daily balance method, the method chosen has little impact on the total finance charge. To then include in salient disclosures an extended explanation of a complicated feature that has very limited impact on costs is contrary to the purposes of the disclosure. It does not aid a consumer in comparing credit cards. We believe that this item is unnecessary for these reasons and should not be part of any disclosure.

Tabular Format

One bill, S.616, requires that the legislative disclosures be presented in a table form to the greatest extent possible. Although, we object to this intrusion into marketing prerogatives, we find it much less objectionable and much more workable if the disclosures are simple and limited in number and complexity. For example, including in the table a lengthy statement explaining how the balance on which the finance charge is determined may render the table unreadable. Equally, if a narrative explanation of the length of grace periods, one for purchases and one for cash advances, is required, the table again becomes too cluttered to be useful. In fact, if the table becomes too complex, it may be confusing as well as misleading to customers. The table is of value only if it can be quickly understood.

Further, the more information contained in the table, the more it becomes an unfair marketing curse. We are also concerned that a complicated tabular format could lead to protracted and costly litigation and civil liability for card issuers due to minor format violations. The requirement could cause a repeat of the Truth-in-Lending litigation horrors that became commonplace under the pre-simplification Truth-in-Lending Act.

The simpler the format, the easier compliance is. It seems that the intent of tabular formatting would be satisfied by requiring disclosures to be "clear and conspicuous," and directing the Federal Reserve to set standards.

Scope: Mailed Solicitations and "Take-Ones"

The Association feels strongly that legislation should limit the additional disclosures to solicitations mailed directly to a consumer by the card issuer and should exclude "take-ones," those applications often found in retail establishments and available to the public in general. The four bills under consideration here today require that disclosures be printed on all applications and solicitations including take-ones. S.616 further requires that such information be accurate on the date the applications are distributed to the retail establishment and that such applications reference that date and indicate that the information is subject to change and the applicant should contact the issuer for current information.

The problem with adding the disclosures to these types of applications, whether or not they are "dated," is that the information easily becomes obsolete. These applications, once distributed, can remain in a retail establishment for several years in some cases. The card issuer has little control over them once they are distributed.

Neither S.241, S.242, nor S.647 addresses the problems associated with disclosure requirements for take-ones. This type of application is treated as all other applications such as solicitations. Under these bills, each time any term of the disclosure changed, the issuer may have to revise and then reprint all forms. All outdated applications would have to be removed and new ones distributed. Because of the tremendous logistical burdens and costs of changing terms of the credit card account, banks would be less inclined to alter these terms.

In many instances, banks must comply with the rules of various state jurisdictions each time they modify the terms of a credit card account. Imposing a new layer of disclosure on promotional literature would in effect make the terms more rigid and reduce the flexibility of issuers to respond to market pressures, perhaps favorably to the consumer.

Even though the application might be "dated" as required by S.616 and indicate that the terms are subject to change, the consumer may nevertheless ignore this part of the statement and instead focus on the terms of the account which are, of course, of greater interest. Consumers may be even more reluctant to inquire about term changes when one set of terms is readily visible.

If the terms of the account have changed and the consumer fails to inquire, the consumer will be misinformed and unable to compare properly, defeating the purpose of the legislation. After receiving the card, the consumer will be confused because the terms are different from those displayed on the original application. Even worse, consumers might not notice the change and might forfeit the opportunity to decline the card if they find the current terms unacceptable.

Requiring disclosures on take-one applications also presents practical problems. Card issuers frequently prepare and order printed thousands of such applications at one time to take advantage of volume printing discounts. They then store the applications in warehouses and distribute them according to need. The requirement of S.616 that the take-one application disclosures be accurate when distributed to the retail establishment makes "warehousing" impossible, thereby increasing printing costs. Also, satisfying this provision becomes impossible for those card issuers who use third parties such as agent banks to make distributions and cannot know the exact time of such distribution.

Although we object to imposing any disclosure requirements on take-one applications, a possible alternative is to require that these types of applications indicate that the specific terms of the account are available by contacting the issuer at an identified address or telephone number. At least this solution assures that obsolete information will not mislead the consumer. At the same time, it reduces card issuers' printing and distribution burdens.

Charge Cards

Any legislation addressing disclosure on credit card applications should apply equally to charge cards, particularly those with open-end credit features. Consumers need information related to these cards as much as they need information on other credit cards. Consumers view these cards with open-end credit features as indistinguishable from typical bank credit cards because they can choose to pay the balance in full each month and avoid finance charges, or repay in installments, subject to a finance charge. When they shop and compare credit cards, they include in their considerations credit cards with open-end credit features. If these charge cards are not subject to the disclosure requirements, they will not be able to compare effectively and choose the card that best suits them. None of the bills under consideration adequately addresses this disparity.

S.241 does not include a "charge card" provision. Since charge cards compete with credit cards, the cost of these cards should be disclosed to assist the consumer when comparing. Although, S.241 does not specifically exclude charge cards that offer open-end credit features, it should clarify that these types of cards are subject to the same disclosures as other credit cards.

S.647 applies only to applications or solicitations to open "any open-end consumer credit plan offered by a bank." Bank is defined by section 19(b)(1) of the Federal Reserve Act. It is uncertain by this definition how exactly the bill intends to define "bank," as section 19(b)(1) offers more than one possible definition, one describing all depository institutions and another referring to banks only and excluding other depository institutions such as savings and loans, credit unions, etc. Thus, not only are charge cards excluded from S.647's provisions, but also charge cards with open-end credit features (and even credit cards) offered by all non-depository institutions and possibly all nonbanks as well.

Lastly, S.616, does provide that charge card applications include disclosure of the annual fee and a statement that charges are due upon receipt of the billing statement. However, S.616 explicitly permits issuers of charge cards with open-end credit features to provide the shorter charge card disclosures rather than the more extensive credit card disclosures. The bill indicates that the shorter disclosures may be substituted only if the fuller disclosures are provided by the creditor before the first extension of credit. This is already the law under the Truth-in-Lending Act.

We believe that first, charge card solicitations should disclose the annual or periodic membership fee that may be imposed for the availability of the account, a statement that charges incurred are due and payable upon receipt of a periodic statement, and a statement that the disclosures are only a summary and later disclosures should be carefully reviewed. Second, any disclosure legislation should indicate that where a charge card allows automatic access to open-end credit, the credit is treated as a credit card and the issuer is required to make the more appropriate disclosures associated with a credit card regarding APR, annual fee, and grace period.

Scope of S.647

S.647, both in regard to its interest rate ceiling and disclosure requirements, applies only to applications and solicitations to open accounts under "any open-end consumer credit plan offered by a bank," as defined by section 19(b)(1), of the Federal Reserve Act. Apart from the confusion regarding the meaning of bank as discussed earlier, this language arouses strenuous objections because it exempts non-depository institutions and possibly nonbanks. The exemption for nonbank and non-depository institution credit issuers has no basis in logic or fairness and indeed appears to thwart the very purpose of encouraging and assisting consumers to compare and shop for credit cards. Consumers are unable to choose the best card, if they can only review products offered by one segment of the industry.

Effective Date

We would like also to comment on the effective date of the legislation. It is crucial that the legislation allow sufficient time 1) to allow the Federal Reserve Board to promulgate regulations and 2) to allow card issuers to implement the new regulations.

Neither S.241 nor S.242 cite an effective date. S.616 provides that regulations shall take effect no later than 90 days after enactment and apply only with respect to applications distributed 90 days after the effective date of the regulations. This time frame is not practical. The Board needs more than 90 days to promulgate regulations in a thorough manner. Card issuers also need more than 90 days to assure compliance. They need time to: 1) review and interpret the new regulations; 2) revise current applications; 3) produce new applications; and 4) distribute new applications. Ninety days is simply too short a period to assure proper and complete compliance with the regulations.

The tight schedules of the legislation detract from efforts of both the Board and the card issuers. Haste in drafting regulations and in complying with new regulations increases the chances of errors and unnecessary expense. The result would be confused and misinformed consumers. It would be in the best interests of all involved, the Board, the card issuers, and consumers, to provide sufficient time for the Board to draft regulations properly and for card issuers to review and implement the regulations without unnecessary risk of errors.

Time to implement the new regulations is especially crucial if the legislation applies to take-ones. Production of take-ones is much more time consuming than production of solicitations, for example. The take-one production process involves more time for changes in the format because of application size and content constraints, because more vendors are needed to complete the final product, and because more time is required to determine distribution points. One hundred fifty days for promulgation of regulations and 150 days for compliance is a minimum.

S.647 provides an effective date of January 1, 1988, or about nine months from today. Assuming prompt enactment, this schedule is still too short for the Board to promulgate high quality regulations and for card issuers to assure proper compliance. Obviously, delays in enactment shorten the preparation time and increase the inadequacies of the effective date.

Federal Preemption

Finally, we would like to address the issue of state preemption. Any legislation should provide that federal law will supercede any state law relating to disclosures in credit card applications and solicitations. Without a federal preemption standard, states could create a patchwork quilt of related but inconsistent or different laws that will ultimately be to the disadvantage of the consumer; varying formats and disclosure terms will diminish the comparative value of the disclosures, making "best" selection more difficult.

In addition, the absence of a federal preemption standard will make disclosure compliance unduly complicated and costly for national or regional card issuers who would be compelled to comply with differing state and federal disclosure requirements. The number of varied compliance requirements would make these card issuers more vulnerable to costly and time-consuming litigation for minor errors.

S.241, S.242 and S.647 do not provide for federal preemption. S.616 offers a partial federal preemption, but in general is unacceptable. That bill only allows the federal law to supercede where the state lacks its own law that explicitly addresses disclosure of information on credit card applications. Any state laws passed on this subject would probably satisfy this minimal standard. Consequently, the federal preemption provision of S.616, in fact, would preempt very little.

We urge that the legislation instead allow federal law to supercede state law relating to these disclosures.

CREDIT CARD INTEREST LIMITS

S.242, introduced by Senator D'Amato and S.647, introduced by Senator Sasser establish maximum interest rates that may be charged on transactions made by credit cards. Under S.242, the rate of interest may "not exceed by more than 4 percentage points the ratio established under section 6621 of the Internal Revenue Code of 1954, as determined by the Board." S.647 establishes a maximum rate of "the sum of six percentage points and the average Federal Reserve discount rate during the six months preceding the date of determination." This maximum rate restriction of S.647 only applies to credit cards offered by banks as defined by section 19(b) of the Federal Reserve Act. We oppose any legislative proposals to impose interest rate controls.

Profitability of Credit Cards

To begin with, as a recent report published by the Federal Reserve Board (Federal Reserve Bulletin, January 1987) confirms, historically, banks have not made exorbitant profits on credit cards, as critics assert. The net earnings of bank card plans before taxes averaged 1.9% of balances outstanding from 1972 through 1985. This is significantly lower than the average net returns on major types of commercial bank loans for the same period: 2.3 percent on real estate mortgages, 2.4 percent on commercial and other loans. The study explains that the recent increase in profitability in 1984 and 1985 is probably not a sign of diminished competition, given the number of credit card plans, the heavy volume of solicitations, and the pace of entry by new competitors. Rather, the recent higher profits are more likely due to other factors such as: 1) drop in funding costs; 2) relaxation in removal of regulatory constraints on credit card interest rates, and 3) a major improvement in the quality of issuers' credit card portfolios following the economic disruptions of the late seventies and early eighties (delinquencies fell to an historically low level in 1984). The study concludes:

> The evidence suggests that profits on credit card plans at banks typically have been low... Therefore, it seems unlikely that card issuers could absorb significant reductions in revenue from finance charges over the long term merely by accepting lower profits.

Secondly, it is true that in the past few years there have been declines in other interest rate indices, without concomitant reduction in credit card rates. However, that disparity is best attributed to the willingness of the industry to take a long-term business risk and maintain a very unprofitable product line through some adverse times, rather than a profiteering motive in the current environment. In the late 70's and early 80's when the cost of funds significantly surpassed any previously recorded highs, credit card rates, due in many cases to usury ceilings, were unable to rise in accordance with the cost of money. Yet many institutions kept their portfolios despite losses during that period. Many other providers sold their portfolios because they were a drain on bank performance. The card business has only recently returned to profitability; and, given the reality of the market, it is clear that any effort to charge more than the market rate will be quickly undercut by scores of aggressive competitors.

High Level of Competition Among Credit Card Issuers

The supply of credit card credit is intensely competitive. Thousands of banks, credit unions, savings-and-loan associations, retailers, and gasoline companies supply credit cards. Many of them issue cards on a nationwide basis. Even the largest card issuers have only a small share of the credit card credit market. In addition, other kinds of consumer credit are effectively competitive with credit card credit. Evidence of competition is found in the frequent announcements of new entrants into the credit card market as well as the thousands of financial institutions already participating in some form of card program. Although the average credit card interest rate is around the 17% to 18% level, the actual range available is quite broad, with rates as low as 9%. Increasingly popular are "affinity" cards which may offer reduced rates and special terms to groups who share a common interest. For example, the AFL-CIO has marketed a card for its members that offers interest rates between 14 1/2% and 16 3/4%, depending on annual fees and grace periods. In the past year, many card issuers have lowered rates. A quick survey of rates around the Washington, D.C. area reveals a variety available to consumers.

Cost of Administering Credit Card Plans

The level and stability of credit card interest rates does not indicate excessive pricing or justify rate controls. Much of the costs of supplying credit cards are administrative and other costs, not costs of funds to card issuers.

Administrative and other costs of credit card credit are much higher than those of other types of loans. With traditional installment loans, after the initial application approval, there are no significant continuing costs of administering the loan; the borrower sends in a check and coupon each month. This contrasts markedly with the credit card system which relies heavily on high volume of small transactions or "loans." Each transaction has cost consequences, e.g., authorization costs and sales transaction processing costs. In addition, card issuers must produce and mail complete billing statements that reflect details of each transaction, credits and debits made to the account, and current finance charges. Error inquiry and resolution add more costs. Credit cards by their nature are more vulnerable to fraud and counterfeiting than other types of loans. The costs associated with these criminal activities come not only from actual losses, but also from the search and implementation of solutions to prevent fraud and counterfeiting. Card issuers have also invested heavily in technologies to move the industry to electronic authorizations and sales transactions. Finally, because credit card loans are unsecured, if the borrower defaults, the card issuer has no security from which it can recoup at least part of its loss. Generally, if the card holder defaults, the card issuer loses whatever balance was outstanding at the time of default.

While costs of funds in commercial money markets have declined in recent years, the demand for credit card services has increased. The general response has been an expansion and improvement in credit card services rather than a reduction in interest rates: card issuers have greatly increased their credit lines per account, have offered a wider array of card features, and have offered credit to new (riskier and therefore costlier) groups of consumers who previously could not obtain credit cards.

Past Effect of State Rate Regulation on Credit Cards

Following the wave of state deregulation of credit card interest rates in the early 1980's, cards issued from control-free states have been much more successful with consumers than cards from states with interest rate ceilings. Since 1980, the national share of bank card credit issued from states without rate ceilings has increased over 13 percent. At the same time, the share of credit from states that still impose rate ceilings had fallen over 17 percent.

Bank card credit from states with "strict" rate controls has fared worse with consumers than credit from states with "moderate" controls. Bank card credit from states with strict "floating" ceilings (similar to those in the proposed national controls) has done worst of all. This market evidence refutes the argument that consumers benefit from interest rate ceilings.

Contraction in Supply of Credit Under Rate Ceilings

A national interest rate ceiling would lead to a contraction in the supply of credit card credit. This would deflect many consumers to more costly or less convenient forms of borrowing and would reduce competition in the supply of consumer credit. The economic effects of a national rate ceiling would be similar to, but more damaging than, those already observed in states with strict ceilings on credit card rates.

Claims that ceilings on interest rates would not restrict the availability of credit cards ignore both historical and economic analysis. The unfortunate experience resulting from our brief encounter with price controls in early 1980 should serve as a painful reminder of the folly resulting from the imposition of governmental price controls on a competitive marketplace. The spring of 1980 saw restrictions on the availability of credit card credit. New cards were very selectively issued. Credit qualifications were tightened. Minimum payment schedules were increased. Some banks actually abandoned the business because of the burdens imposed, thus contributing to a temporarily less competitive marketplace.

If ceilings were imposed, card issuers would "reprice" their services to some extent, for example, by raising annual fees or increasing charges for late payments and account inquiries, but the opportunities for repricing appear to be limited. Issuers would then be forced to allocate credit by non-price means, such as by tightening credit standards and restricting cards to local markets and regular customers in an effort to

As the staff of the Federal Reserve Board concluded in its April 1986 study, a federally mandated ceiling could result in reduced credit availability, subsidization of the cost of credit by cash customers, elimination of grace periods, and other detriments to retail consumers.

As retailers, we really reach a portion of the market that is considerably different from that of third party card issuers, because we cover income levels that go relatively deep into the market. We have more cards in each market than normally third party cards do. As a result, if those people were taken out of the market, and I'm talking about good paying customers at lower income levels, they would not have the source of credit that they now have through retailing.

In connection with disclosure, retailers generally fully support disclosure. We have had excellent disclosure to our customers for many years. We don't really believe that additional disclosures are necessary for retailers, because under present law retailers must provide their customers with the notifications required in your bill prior to their incurring any type of fee or charges. The vast majority of retailers provide a free credit period, and we know of none who charge an annual fee, and I think that is very important.

If, however, Congress concludes that additional disclosures are necessary at the Federal level, we recommend that you simplify them as has been stated several times today.

We have some concern with certain, we believe, unintended mechanical problems in the bill. However, I think they could be ironed out, if we worked with some of your people.

Part of our problem is with "Take One" applications, especially for national retailers who would have to incorporate multi-State information into one brochure.

Finally, the effective date has been discussed, and I think the reasons for that have been set forth very well. I've worked with issuing new brochures, and going to a printer and trying to get them out, takes a great deal more time than has been indicated.

In summary, I would like to say that retail credit is different in certain respects from every other kind of credit we have heard about today. Many retailers lose money on their credit operations. We serve a broader constituency than do other credit issuers. We serve the low and middle income group of customers that, frankly, would have a difficult time finding other sources of credit.

I want to thank you, Mr. Chairman, for allowing me to present the views of retailers.

[Complete prepared statement of Mr. Zoroya follows:]

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STATEMENT OF

NATIONAL RETAIL MERCHANTS ASSOCIATION

ON

CREDIT CARD RATES AND DISCLOSURES

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
U.S. SENATE

MARCH 26, 1987

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Mr. Chairman, members of the Subcommittee, I am Michael Zoroya, Retail Services Consultant, The May Department Stores Company. I am also a member of the Federal Reserve Board's Consumer Advisory Council. On behalf of the National Retail Merchants Association ("NRMA"), I welcome the opportunity to present the views of retailing on proposed legislation to impose a rate cap on credit cards and require certain disclosures in credit card applications and preapproved solicitations.

NRMA is the nation's largest trade association for the general merchandise retailing industry. Its members operate 45,000 leading department, chain, independent and specialty stores in all 50 states. NRMA members' annual sales exceed $150 billion, although the vast majority of NRMA's members are small, independent retailers whose annual sales are less than $1 million. Virtually all of NRMA's members extend credit by issuing their own credit cards or by accepting third-party credit cards. For this reason, these hearings are of great importance to the retail industry.

THE PROPOSED LEGISLATION

The basic goal of S. 241 and S. 616 is to address the perceived problem of consumers being unaware of credit costs before they receive their credit card. At present, the Truth in Lending Act requires full cost of credit disclosure before the first transaction is made under the credit card plan, but a credit card issuer is not required to disclose key information, such as the rate of finance charge, or the amount of the annual fee, until after the consumer requests the credit card.

When S. 616 was introduced, it was stated that the hearing will also consider bills that would impose a cap on credit card rates, as well as explore three other concerns: whether it is possible to hold the balance calculation method constant "so as to assure valid comparisons" between competing credit card plans; whether it is appropriate for banks to change credit insurers without letting consumers know; and whether the consumer is getting a "bad deal" on insurance for lost credit cards.

S. 242 and S. 647 would impose a ceiling on credit card rates, and the latter bill, applicable only to issuers of bank cards, would also require disclosures in applications and solicitations to open a bank card account.

This statement addresses the issue of credit card rates and disclosures. As to the three other issues, mentioned above, we will briefly address only the one that relates to holding the balance method constant.

CREDIT CARD RATES

Federally mandated rate restrictions are unnecessary and inappropriate, because consumers have an effective array of credit choices and competition is keeping rates in line with credit costs. The imposition of restrictive federal rate ceilings could result in reduced credit availability, subsidization of the cost of credit by cash customers, and other detriments to consumers. NRMA has prepared a paper discussing why Congress should not enact a rate cap on credit cards. It will be made available to this Subcommittee as a separate submission. Set forth below is a summary of the key points made in the NRMA paper on credit card rates. These same points are made by the Federal Reserve Board in its April 1986 study entitled The Effects of Proposed Credit Card Interest Rate Ceilings on Consumers and Creditors.

Effective Competition and Regulation of Credit Terms

The retail industry throughout the nation is highly competitive in terms of the goods and services it offers, including offering credit plans which are attractive to the consumer.

The consumer has numerous options. In addition to retailers' proprietary credit card plans, bank cards are widely accepted by retailers for purchases in their stores. New market entrants (Discover Card, Optima, etc.) demonstrate that the credit card market is indeed competitive. In addition to having choices among credit cards, consumers have a variety of other types of credit available to them -- personal loans, check-accessed overdrafts, lines of credit secured by residential equity, etc. Hence, no consumer is "locked in" to a credit card rate which the consumer considers to be too high. Consumers choose to make purchases with their credit card, knowing in advance the rate charged by the credit card issuer, because they want to do so.

Existing federal law properly relies upon competition to ensure fair rates, while providing significant protection to consumers to assure that the manner in which charge account plans operate is fair, and that competing

plans can be understood and compared. Each state's laws contain extensive provisions regulating credit card accounts, which (1) limit the ways and circumstances in which merchants may assess finance and other charges; (2) ensure that consumers are treated fairly; and (3) in combination with federal law, ensure that consumers are able to make an informed choice among their various credit options.

The Arguments for Restrictive Rate Ceilings

The Excessive Profits Issue:

Proponents of restrictive rate ceilings argue that credit card issuers are reaping excessive profits. To the contrary, it can be documented that revenues from retailers' credit card plans are reasonable in relation to the costs of operating the plan.

Some proponents of a federal rate cap argue that credit card rates are too high in relation to the cost of funds and, as a result, banks, retailers, finance companies, and other credit card issuers are making unreasonable profits at the expense of consumers. To the contrary, retailers' finance charge rates cannot properly be evaluated by focusing on the prime rate because retailers' credit costs are not primarily a reflection of the prime rate or other short-term cost of funds. Credit granting involves a number of factors other than the cost of funds, including: operating expense, as well as credit losses due to bad debt and fraud.

A major new study prepared by Touche Ross & Co. confirms the results of previous studies that competition has kept retailers' credit card rates in line with costs. The data from the Touche Ross Study reveal a significant deficiency of revenues in relation to costs. The data documents that retailers continue to extend credit as a marketing tool but that competitive pressures do not permit all retailers to cover the full cost of providing this service.

The Issue of Comparing Retail Credit Card Plans to Bank Plans:

Proponents of restrictive rate ceilings argue that some banks have lowered credit rates, but retailers are unresponsive. In fact, retailers' card plans are distinguishable from bank card plans.

Proponents of credit card rate restrictions have pointed to recent finance charge rate reductions on some bank credit card plans as a basis for arguing that lower rates

should be mandated by legislation for all credit grantors. To the contrary, such reductions prove that there is competition in the credit marketplace and therefore that legislation is unnecessary. Such arguments also ignore fundamental differences in costs and revenues under bank card plans as compared with retail plans.

On the cost side, bank card accounts generally involve much larger balances than do retail accounts. Thus, assuming that account processing costs are about the same in both cases, in relation to outstanding balances, the costs will be lower for banks than for retailers. There are significant differences on the revenue side as well. Unlike retailers, which typically obtain all of their credit card revenue from finance charges, most banks levy an annual fee for issuing the card. In addition, banks obtain revenue from the merchant discount, which ranges from 2-6% of each sale.

This comparison should not be interpreted as criticism of bank cards. All creditors must find means to generate revenues to cover the costs which are appropriate to their respective operations. Consumers are offered a choice and can select the most convenient, cost-effective alternative for them. Competition should be allowed to operate in this sector, just as it does generally in our economic system.

The Issue of Benefits to Consumers:

Proponents of restrictive rate ceilings argue that consumers will be benefitted by reducing their expenses and helping manage their debt. On the contrary, rate ceilings do not benefit consumers because they restrict the availability of credit and may result in cash customers having to subsidize credit used by others.

Proponents of ceilings on credit card rates believe that consumers will benefit if rates are forced down by law. The evidence is to the contrary. The result of such restrictions would be reduced credit availability, among other adverse consequences. Historically, retail creditors have made credit available to a wide segment of the consumer spectrum. For many, particularly the young, the elderly, and those on low or fixed incomes, the retail credit card is the only means at their disposal to make discretionary purchases, as well as to buy goods and services that are essential to maintain an adequate standard of living. Rate restrictions could, therefore, deny many of these people the opportunity to qualify for retail credit.

Rate restrictions would also increase and misallocate costs in other ways. Restricting finance charge revenue could force retailers to recoup those losses by raising cash prices. In that way, customers who pay in cash for such merchandise would subsidize the cost of providing credit services not used by them. Increases in merchandise prices would not be limited to retailers who offer their own credit plans. Rate restrictions could lead banks to increase the merchant discount and thus put upward pressure on retail prices.

Accordingly, NRMA urges Congress not to enact legislation that would place a cap on credit card rates. Competition among credit grantors, in a credit marketplace requiring fair practices and full disclosure, will maximize consumer benefits and avoid economic distortions. There is no need for federal legislation to set the price of credit.

BALANCE METHOD REGULATION

The issue of balance method regulation on the federal level was discussed in detail in NRMA's testimony before this Subcommittee during its hearings on May 21, 1986, on S. 2140, S. 2264 and S. 2421. The latter bill would have mandated, for third-party credit card issuers, adoption of the average daily balance method or some other method which would yield lower finance charges. As we explained in that statement, this proposal is objectionable on several grounds. First, mandating a particular balance method has a direct effect upon card issuers' revenue. Thus, it is a form of federal rate-setting. Second, this proposal would conflict with a vast body of state law which prescribes various balance methods as part of an integrated approach to the regulation of rates, creditors' remedies and consumers' rights. Third, this proposal could impose significant burdens upon retailers in general and small retailers in particular. This is because the average daily balance method requires sophisticated computer software that is not readily available to small retailers.

As in the case of a rate cap, discussed above, the imposition of a federally-mandated, uniform balance calculation method could have numerous adverse consequences for consumers, such as forcing retailers to offset lost revenues by reducing the availability of credit, or increasing the cash price of goods, thus forcing all buyers to subsidize part of the cost of financing the credit card operation. In sum, the notion of regulating credit card

issuers' balance computation method is unsound federal legislative policy and unjustified on economic grounds.

The balance of this statement addresses the two bills introduced to require disclosures in credit card applications and solicitations.

CREDIT CARD DISCLOSURES

S. 241, introduced by Senator D'Amato on January 6, 1987, would amend Section 127 of the Truth in Lending Act to require that any application or solicitation for a credit card account shall disclose: (1) the annual percentage rate; (2) the grace period for avoiding finance charge; (3) any minimum or fixed finance charge; and (4) any annual or other charge or fee required to be paid for the use of the account. This bill would apply to any application or solicitation. Thus, it would require disclosures in oral solicitations as well as applications in catalogs, newspapers and other publications. S. 241 would also require all credit card issuers to submit quarterly to the Federal Reserve Board information required to be disclosed to consumers, so that the Board could make this information available to the public.

S. 616, introduced by Senator Dodd for himself and Chairman Proxmire on February 26, 1987, is similar to the bill that passed the House at the end of the 99th Congress (H.R. 5613), which has been reintroduced and is currently under consideration in the House (H.R. 515), among other bills dealing with credit card disclosures (H.R. 244 and H.R. 1086). As you know, H.R. 515 was approved, as amended, by the House Banking Subcommittee on Consumer Affairs on March 18, 1987.

S. 616 would amend Section 127 of the Truth in Lending Act to require disclosure in credit card applications and solicitations of: (1) the annual percentage rate; (2) any annual or other fee or charge imposed for issuance or use of the card; (3) the grace period; and (4) a statement of how the balance on which the finance charge is computed is determined.

Since the requirements of S. 616 would apply to all applications and solicitations, telephone, catalog and newspaper solicitations would be covered as well. Moreover, the language of this bill is so broad that it could be interpreted as applying to certain advertisements which merely mention credit card plans. "Take-one" applications

would be subject to a special rule. They would be required to contain the above-mentioned four items of information and this information "must be accurate as of the date the applications are distributed to the commercial retail establishments". "Take-one" applications would be required to contain a reference to the date on which the application was prepared for distribution and a statement in a conspicuous and prominent location that the information is subject to change and the applicant should contact the creditor for information on any change after the application was distributed. Charge cards (i.e., cards which are not subject to a finance charge) would be required to disclose: (1) the annual fee or other charge for issuance or use of the card; and (2) a statement that charges are due and payable upon receipt of the periodic statement.

The disclosures mandated by S. 616 would be required to appear in a tabular format to be prescribed by the Federal Reserve Board. Similar state laws would not be superceded if the state law "explicitly requires the disclosure of such information in a credit card application or solicitation." Finally, this bill would become effective 90 days after its enactment.

Additional Disclosures Are Not Needed

NRMA believes that the need to require retailers to provide additional disclosures to the applicants for their credit cards has not been established. First, many retailers' accounts are opened through applications made available to customers in the stores, generally called "take-one" applications. These applications are often accompanied by the account agreement, which contains the initial Truth in Lending disclosures.

Second, and of more importance, even in those cases when the account agreement is not part of the application, retailers do not impose annual fees (such fees are not permitted in many states), one of the key items of information that proponents of these bills argue is unfairly withheld from such solicitations. Thus, applicants for retail credit cards receive all cost of credit disclosures, pursuant to existing federal law, before they incur any charges on the account.

Moreover, unless carefully limited, imposing an additional disclosure requirement for the application or preapproved solicitation may be unworkable for national and regional retailers. Unlike financial institutions, which

often utilize a single or uniform rate structure under the law of their home state, retailers' rates and other terms are governed by the laws of the state of the customer's residence. As a consequence, under these bills national retailers would be forced to incorporate their 50-state rate chart into their credit card applications and preapproved solicitations, in addition to incorporating this information into their account agreements, or be forced to print a separate application or solicitation for each state. The former would constitute information overload and the latter would be an extremely expensive and cumbersome process.

NRMA is concerned that Congress will act precipitously to make fundamental changes in Truth in Lending, a law which has served consumers and credit card issuers well for 18 years. Congress considered every facet of the need to provide consumers with advance disclosures during the 10-year period leading up to passage, in 1969, of the most important and comprehensive federal credit law ever enacted. After an exhaustive review of all aspects of creditors' operations, it was determined that consumers should receive the basic information about the cost of open-end credit before the first transaction on the account.

Admittedly, the popularity of credit cards was not as dramatic when Truth in Lending was enacted as it is now, but the basic approach to the timing of credit card disclosures is as sound today as it was in 1969. If a problem exists, and we concede this point only for the purpose of suggesting the most appropriate remedy, legislation should carefully balance the benefits to consumers with the increased burdens upon creditors. In our view, both S. 241 and S. 616 fail to do this, for the reasons explained below.

Deficiencies in Proposed Legislation

- Coverage of "Take-Ones"

S. 241 and S. 616 would require advance disclosure of the above-mentioned information in "take-one" applications, and certain other solicitations, including magazine advertisements and applications which are not directed to a particular consumer by name.

"Take-one" applications should not be covered. These applications are generally printed in a national format and therefore they would have to be lengthened considerably to reflect information which, in the case of retailers, often

is already made available as part of the "take-one" form. Even when the account agreement is not part of the "take-one" form, requiring national creditors to insert their entire 50-state rate chart would be burdensome and costly. Instead, any credit card disclosure bill should include language eliminating "take-ones" from coverage or, at most, should require the creditor to provide an address or phone number where the consumer can obtain the information that would otherwise be required to be disclosed.

Additionally, the dating requirement of S. 616 represents legislative overkill. The bill would require that "take-one" applications include disclosure of the "date on which the application is prepared for distribution to a commercial retail establishment." Card issuers prepare and have printed thousands of such applications at the same time to take advantage of volume printing discounts. Card issuers also warehouse large quantities of these applications for periods of time. "Dating" requirements would greatly increase printing costs, particularly for smaller creditors. Moreover, outdated "take-ones" are of no value to the consumer and may even serve to mislead or confuse consumers.

S. 616 further requires that the application contain a statement, in a conspicuous and prominent place, that "(1) the information contained in the application is subject to change and (2) the applicant should contact the creditor for information on any change in the information contained in the application since the application was distributed." Moreover, the information in "take-ones" must be "accurate as of the date the applications are distributed to the commercial retail establishments." The former disclosure requirement is excessive and unnecessary. The latter requirement will be practically impossible to satisfy, since card issuers frequently use third parties to make distributions of "take-ones," and card issuers generally will not know the exact timing of such distributions.

Additional disclosures about information being subject to change, and "dating" requirements, are not needed. The current, up-to-date disclosure of the terms of the account is always provided, as required by federal law, when the account is opened. The better approach is that taken by two of the three bills which have been introduced in the House -- H.R. 1086 (take-ones are excluded) and H.R. 244 (requires take-ones to contain only a reference to contacting the creditor for additional information).

Moreover, the failure of both S. 241 and S. 616 to limit coverage to written solicitations is a serious flaw. It simply is not feasible to incorporate the disclosures required by these bills into the brief oral presentation that typifies telephone account solicitations. These solicitations are an effective means of promoting credit card plans, particularly for new entrants into the marketplace, and they are a definite benefit to consumers, who appreciate the convenience of being able to request a credit card in this manner. This legislation could effectively eliminate this form of competition in the credit card marketplace, unless it is limited to mailed solicitations.

o The Requirement to Disclose the Balance Method

The requirement in S. 616 to disclose the balance method for computing finance charges should be deleted. We strongly disagree with the statement, made when this bill was introduced, that card issuers "should be required to disclose their method so that consumers can compare it with other ways used by different issuers" (Cong. Record, February 27, 1986, p. S. 2582).

This information would not be useful to compare the plans of various card issuers, for several reasons. First, it cannot be communicated in a short sentence. Rather, the description of a creditor's balance method tends to be a lengthy statement, which includes exceptions for various states, and references to inclusion or exclusion of various fees.

Second, even if this description could be reduced to a single sentence, consumers would not benefit from receiving an explanation of the balance method because such a description does not, and cannot, tell the consumer which balance method results in a lower finance charge. To illustrate this point, set forth below, using the specific balance method language prescribed by the Federal Reserve Board in Regulation Z, are two common methods of computing finance charges:

Method A	Method B
We figure the finance charge on your account by applying the periodic rate to the amount you owe at the beginning of each billing cycle minus any unpaid finance charges. We do not subtract any payments or credits received during the billing cycle.	We figure the finance charge on your account by applying the periodic rate to the "average daily balance" of your account (including current transactions). To get the "average daily balance" we take the beginning balance of your account each day, add any new purchases and subtract any payments or credits, and unpaid finance charges. This gives us the daily balance. Then, we add up all the daily balances for the billing cycle and divide the total by the number of days in the billing cycle. This gives us the "average daily balance."

Which of these two methods results in a lower finance charge? The answer is: sometimes Method A and sometimes Method B. Method A, commonly known as the "previous balance method", will yield more finance charge than Method B (one of several versions of the average daily balance method), if no purchase is made in the current billing cycle, assuming that the same beginning balance exists and the same partial payment is made under both methods. Conversely, Method B will yield more finance charge than Method A, all other things being the same, if a purchase is made in the current billing cycle. The point is that a particular balance method (and there are several variations of these two) can yield more or less finance charge than another balance method, depending upon the consumer's payment and purchase patterns. In addition to constituting a classic case of "information overload", this disclosure would be virtually useless to the consumer in comparing the costs of different credit card plans. It should be eliminated.

o The Requirement to Disclose "Other Fees" for Use of the Card

Any advance disclosure of fees should be limited to the annual membership fee that may be imposed for the availability of the credit card account, rather than for its use. Although retailers do not impose annual fees, and

Senator DODD. Thank you very, very much. Mr. Rohner?

STATEMENT OF RALPH ROHNER, SPECIAL COUNSEL TO CONSUMER BANKERS OF AMERICA, DEAN OF COLUMBUS SCHOOL OF LAW, CATHOLIC UNIVERSITY OF AMERICA, REPRESENTING CONSUMER BANKERS OF AMERICA

Mr. ROHNER. Thank you, Mr. Chairman. On behalf of the Consumer Bankers Association, I am delighted to appear this afternoon. In the interests of time and the time of day, I will be as brief as I possibly can. We have listened very carefully to the theme that you sounded this morning and several times throughout today's hearing, and I think that the gist of our testimony is to the effect that we support that approach virtually absolutely.

Let me explain. It seems to me that what occasioned these hearings is some weakness in the existing Truth-in-Lending laws which simply do not currently specify disclosure at the solicitation and application stage. We support the notion that an appropriate disclosure at that stage is called for. We understand your views that that is an appropriate way to proceed. We understand also your admonition that rate caps, while not your preference, may lurk in the background.

I think our observation to that, Mr. Chairman, is again that we support that approach, but also acknowledge that in the history of consumer credit, rate caps have almost always proved artificial, imperfect, distortive of the marketplace and, in short, they don't work very well.

On the contrary, our experience over the last 15 or 20 years with a comprehensive, well-thought, well-thought-through and well-policed disclosure regime is that disclosure does work. Consumers do appreciate information if it is made available to them, and it is in that vein that we support the disclosure approach of these bills.

With respect to that disclosure, we would have some comments and some particular technical matters on which we would be happy to work with your staff. Let me acknowledge only several. We do believe that it is important that a disclosure requirement at the application, solicitation stage be applicable to all cards, including charge cards, because the information and the comparative use of that information is pertinent to consumers regardless of the nature of the card.

We would hope that any information that emerges from the Congress would deal forthrightly with State laws that proported to add different or varying disclosures at the same stage. There is a preemptive approach, so as to make it possible for creditors to comply readily.

We would hope, in any event, that you would give the Federal Reserve Board, the presumed regulation writer in this area, some considerable discretion to use its cumulative experience and ingenuity in designing the disclosure techniques that will work without being unduly burdensome.

As to the actual content of the disclosure, our prepared testimony elaborates in more detail, but we essentially agree, I think, with most of the other industry spokespersons today. The critical elements, the ones that a consumer is likely to react to at that stage

are, of course, the annual percentage rate, although, frankly, Senator, I think the rate, as an item of overwhelming consumer interest, has been overstated. There are many other aspects of the card plan that may be as attractive as a nominal rate, which in many as half the cases may never be imposed. But the annual percentage rate, the accompanying fee, if there is one, and a grace period disclosure.

We are very encouraged and hope we will have a chance to work with your staff on the kind of standardized grace period disclosure that you raised earlier and that Mr. Craft has on his bank's form.

Beyond that, we seriously question whether additional potentially detailed disclosures at the solicitation stage would be either necessary or wise. It has been said a number of times, but it is worth repeating perhaps that there already exist in the Truth-in-Lending law the array of disclosures that arrive with the card. There are also requirements for disclosures in any solicitation materials that amount to advertisements. There are degrees of coverage or degrees of disclosure responsibility already in place. What is proposed, essentially, in your bill, were some refinements we believe would fill a gap that exists, and we are happy to support it and work with your staff to refine it.

[The complete prepared statement of Ralph J. Rohner follows:]

rarely impose "other fees" for "use" of the card, both S. 241 and S. 616 would require other issuers of cards to disclose all charges for use of the card. This would substantially lengthen the disclosure, without providing any corresponding consumer benefit.

S. 241 clearly would require, and S. 616 could also be interpreted to require, disclosure of any minimum charge that may be imposed under a credit card account. Many retailers impose a 50 cent minimum finance charge, in an effort to cover the cost of generating a monthly bill that carries a small balance (although we note that this minimum charge, established at this level by Truth in Lending years ago, is not at present sufficient to cover the cost of preparing and mailing a periodic statement). This nominal minimum charge is only infrequently applicable to a particular consumer's balance (in a state where an 18% rate is charged, the 50 cent minimum finance charge is not applicable until the balance due is $33.33 or less), and it is imposed in only certain states where it is permitted. Yet it would have to be disclosed (presumably along with a list of states where it is not imposed) in the application and solicitation disclosures. This is another example of "information overload" in connection with what should be an abbreviated credit-shopping disclosure. Under current law all fees, including any minimum finance charge, must be disclosed clearly and conspicuously in the initial disclosure statement. This information is simply not of sufficient consequence to consumers, in making the decision to choose among different card programs, to require its inclusion in the advance disclosures.

This provision could also be interpreted to require the disclosure of other terms, such as fees for late payment, over-the-limit charges, charges for checks submitted for payment and returned unpaid, and numerous other potential fees, which are generally associated with misuse of a card account or failure to conform to the agreement with the card issuer. Again, this is not the type of significant "shopping" information that is appropriate for disclosure in a solicitation to open a credit card account.

o "Tabular Format" Disclosure Requirement

S. 616 would mandate "precise" formatting requirements. This could lead to protracted and costly litigation and civil liability for card issuers due to minor technical formatting violations. If the statute does not protect card issuers from frivolous litigation over minor violations, there is likely to be a repeat of the Truth in

Lending litigation excesses that were commonplace under pre-simplified Truth in Lending. Instead of specific tabular formatting requirements, the preferable approach is that of S. 241, which requires that disclosures be "clear and conspicuous," the current standard that has worked well for years in the Truth in Lending Act.

o Credit Card Disclosure Legislation Should Amend Section 143

S. 241 and S. 616 would amend Section 127 of the Truth in Lending Act, which prescribes the comprehensive disclosures which must appear in the initial account agreement and periodic statement, among other provisions. As noted earlier, the purpose of the legislation under consideration here is to curb perceived excesses in promoting acceptance of cards. Advance disclosures that promote credit cards are more properly treated as "advertisements" for Truth in Lending purposes. Thus, these provisions should be included under Section 143, which governs credit advertising.

o Preemption Standard Is Inadequate

Federal legislation in this area should preempt similar state disclosure laws. S. 241 contains no provision addressing this issue. S. 616 would allow states to negate the federal preemption by passing state laws which "explicitly require" disclosures in credit card applications or solicitations. Virtually any state law that is enacted on this subject would satisfy this minimal standard. Thus, the federal preemption provision in S. 616 would have little or no effect upon similar state laws.

Without an effective federal preemption standard, compliance will be unduly complicated for national and regional card issuers, who will be forced to comply with different state and federal disclosure requirements. At least three states have already enacted new account solicitation disclosure requirements (California, Virginia and Wisconsin), and others are likely to follow in the near future. Differing state standards, and additional federal standards, would make it difficult for consumers to compare solicitation disclosures among cards being offered by creditors operating in different states or regions. Moreover, it would be virtually impossible for national creditors to meet all these different standards in one uniform disclosure.

o A Sufficient Effective Date Is Needed

The effective date in S. 616 is far too early. The legislation calls for the Federal Reserve Board's regulation to be effective within 90 days of enactment. A three-month period is simply not enough time for: (1) the Board to draft and publish for comment a proposed new consumer disclosure regulation, (2) the Board to review and incorporate comments from those affected, and publish a final regulation, and (3) card issuers to reprint new forms and substitute them for all existing forms and applications in circulation.

New legislation should not deviate from the lead time adopted by Congress in 1981 under the Truth in Lending Simplification and Reform Act. At that time, after carefully considering the issue of the burdens caused by the obligation to constantly revise existing forms to comply with new rules, Congress adopted a mandatory lead time for complying with new regulations under Truth in Lending of "that October 1 which follows by at least six months the date of promulgation" (Truth in Lending Act Section 105(d)). This new statutory provision was enacted to permit creditors to make an orderly transition from existing to new forms, and it should not be ignored. It is particularly appropriate in the case of any new law requiring advance disclosures in new application forms.

CONCLUSION

Retailing is strongly opposed to federal legislation which would impose a rate cap, or the enactment of other rate-making legislation, such as prescribing a particular balance method for computing finance charges. We believe that these proposals are wholly unjustified on economic grounds. The price of the service of credit is best determined by the marketplace, which is highly competitive. Consumers will benefit most when they have a wide variety of choices among various creditors, coupled with sufficient information on which to make those choices.

In spite of our belief that additional credit card disclosures are not needed, retailing is willing to accept the additional responsibilities to provide advance disclosures, if Congress deems it necessary to give the public more timely information to make credit decisions. For this reason, retailing will not oppose adoption of disclosure requirements which are limited, in mailed solicitations, to three key items of information - the annual percentage rate, the annual fee, and the grace period. The grace period

disclosure should be limited to informing the consumer whether or not a grace period for purchases is provided. This approach will ensure that no additional verbiage will detract from these three important items of information.

We believe that S. 241 and S. 616 are flawed, both in terms of the types of applications they cover and in terms of the nature of the information that would be required to be disclosed. That is, "take-one" applications and applications in catalogs and other publications should be excluded from coverage. At most, these applications should be required to include a notice that specific terms may be obtained by contacting the creditor at a specified address or telephone number. Moreover, tabular formatting should be eliminated because it is an unnecessary burden for creditors and an invitation to challenge the disclosures on technical rather than substantive grounds. Finally, any legislation in this area should preempt similar state laws.

NRMA appreciates the opportunity to present the views of retailing on this important issue.

TESTIMONY OF
THE CONSUMER BANKERS ASSOCIATION
BEFORE THE
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER AFFAIRS
OF THE
COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
OF THE
UNITED STATES SENATE
ON
LEGISLATION ON CREDIT CARD DISCLOSURES AND
LEGISLATION ON CREDIT CARD INTEREST RATE CEILINGS

March 26, 1987

Mr. Chairman, members of the Subcommittee, I am Ralph J. Rohner, Dean of the Columbus School of Law, Catholic University, and Special Counsel to the Consumer Bankers Association ("CBA").[1] On behalf of CBA, I want to thank this Subcommittee for the opportunity to testify on proposed legislation to impose additional disclosure requirements on credit card applications and solicitations, and to set a national ceiling on credit card interest rates.

At the very outset, CBA would like to state its strong and unwavering opposition to any legislation that would impose a ceiling on credit card interest rates, such as that proposed in S. 242 and S. 647. We firmly believe that such a ceiling or "cap" would prove harmful to consumers, by limiting credit card availability to higher-income, less risky customers, and by restricting other credit card features, such as the grace period. In this regard, it is important to understand that, according to Federal Reserve Board studies, 47% of all credit card customers almost always pay their monthly bills in full. As a result, these customers have an effective annual percentage rate of zero because of the grace period provided under most credit card programs. Such customers cannot be helped by an interest rate ceiling. On the contrary, they can only be hurt if a rate ceiling results in loss or reduction of the grace period.

Furthermore, we believe that an artificial cap on credit card interest rates would have an anticompetitive effect on the credit card market. An interest rate arbitrarily imposed by statute, rather than by the free market forces which now set credit card interest rates, could force many card issuers out of the market altogether. Such a cap would also act as a disincentive to the remaining card issuers to respond to market forces dictating an even lower rate. For these reasons, we are strongly and unalterably opposed to any legislation to cap interest rates on credit card accounts. We therefore welcome Chairman Dodd's statement, reported in the March 20, 1987 issue of The American Banker, that this Subcommittee will not report any credit card legislation to the full Senate Banking Committee if the House of Representatives continues to pursue legislation to cap credit card interest rates.

Disclosure legislation is another matter, however. The CBA has actively endorsed and continues to support disclosure of the key terms of credit card accounts in connection with solicitations and applications mailed directly to consumers. As we did in the last session of Congress, we would like to express our support for legislation which would provide the consumer at an early stage with information to enable effective comparison shopping among all competing credit and charge cards.

By the same token, we would be remiss if we did not underscore the wealth of disclosure information already required by federal law before the consumer becomes obligated on a credit card account. At the very least, Congress should be wary of duplicating the detailed information required by existing law in its efforts to provide useful shopping information.

Of all the credit card legislation currently being considered by Congress, we believe that legislation such as that introduced in the House of Representatives by Congressman Doug Barnard of Georgia (H.R. 1086) would most effectively provide consumers with the key credit card terms, without imposing undue burdens on the operations of card issuers. As just mentioned, the existing Truth in Lending Act already requires that consumers be given comprehensive disclosures before they can use a credit card account. So the question is what additional disclosures should be given to consumers. The Barnard bill would require all applications and solicitations for credit and charge cards mailed directly to consumers to disclose the principal terms of any credit plan: the annual percentage rate, the annual fee, and the existence of a grace period. We believe that H.R. 1086 is preferable to all three disclosure bills currently being considered by the Senate, namely S. 241, S. 616 and S. 647.

We urge this Subcommittee to adopt the Barnard approach in applying any additional disclosure requirements to all credit and charge card issuers. S. 647 would require additional disclosure only by banks. S. 241 and S. 647 would apply only to credit cards, exempting charge cards. Credit or charge cards issued by retailers or other non-bank institutions, however, are functionally equivalent to bank-issued cards. Moreover, charge cards providing automatic access to open-end credit are virtually

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1 The CBA is a nonprofit organization that was organized in October 1919 to provide a voice for the retail banking industry. Today, membership in CBA is open to any federally-insured depository institution, including commercial banks, thrifts and credit unions. Combined, CBA members now hold over 70% of all consumer credit outstandings held by commercial banks and over 80% of the consumer deposit accounts held by commercial banks.

indistinguishable from bank credit cards. Both charge cards and non-bank issued credit cards compete directly with typical bank credit cards. Most importantly, bank credit cards represent less than 20% of all credit card accounts. Therefore, unless a consumer engaged in comparison shopping is given the opportunity to compare the principal terms of the remaining 80% of the card market, any consumer protection supposedly afforded by additional disclosure legislation would at best be illusory.

The Barnard bill would require disclosure of the three terms that would be of the most immediate use to consumers in comparing competing card plans. The key factors to be disclosed would be the annual percentage rate, whether fixed or variable; the annual fee; and the existence of a grace period. By comparison, S. 241, S. 616 and S. 647 would require such disclosures as a statement of the balance computation method, a lengthy narrative description of grace periods, and the disclosure of all fees or charges imposed under a card plan. Such information would duplicate the comprehensive disclosures already mandated by the Truth in Lending Act for all credit card accounts. More significantly, however, the complex and lengthy disclosure statements that would be required by the three Senate bills would be contrary to the very purpose of additional disclosure legislation, namely to enable consumers to quickly and easily compare competing credit and charge card plans.

The Barnard bill applies only to written applications and solicitations mailed directly to consumers, and not to applications and solicitations generally available at merchants, branches, and other public locations (generally known as "take-one" applications), or applications contained in catalogs or magazine advertisements. We strongly support this approach. Most of the criticism concerning the lack of credit and charge card disclosure has been provoked by the increasing use of direct mail solicitations by banks, retailers, and other credit and charge card issuers seeking to expand their customer relationships.

We agree that such solicitations should disclose significant credit terms to consumers. However, extending these additional requirements to take-ones and magazine advertisements would impose excessive logistical burdens on the operations of credit and charge card issuers, who must print and distribute such materials in bulk and far in advance of distribution. We therefore strongly urge this Subcommittee to reject the provisions of S. 241, S. 616 and S. 647 which would impose disclosure requirements on all applications and solicitations.

Once again, let me thank you on behalf of the CBA for letting us present our views on the proposed credit card legislation. A more complete discussion of our views on the various disclosure and interest rate cap proposals is set forth below. I would be happy, however, to answer any questions you may have.

I. STATUTORY CEILING ON CREDIT CARD INTEREST RATES.

The Subcommittee on Consumer Affairs and Coinage of the House Banking Committee has reported to the full Committee legislation which would impose a credit card interest rate cap of 8% over the yield on one-year Treasury bills. Similarly, in the Senate, S. 647 would limit credit card interest rates to 6% above the discount rate as determined quarterly by the Federal Reserve Board. In addition, S. 242 would limit such interest rates to 4% above "the ratio established under Section 6621 of the Internal Revenue Code of 1954." Since Section 6621 refers to three different rates -- a short-term federal rate, an overpayment rate, and an underpayment rate -- it is difficult to determine exactly what cap would be applied to credit card interest rates under S. 242.

The CBA strongly opposes any legislation to impose ceilings on credit card interest rates, because we firmly believe that a statutorily-imposed ceiling would have significant adverse effects on both consumers and the credit card industry. In considering the impact of such legislation, it is imperative to understand how many consumers might be adversely affected, without receiving any compensating benefit. According to a recent study by the Federal Reserve Board, 47% of all cardholders pay their credit card account in full before the expiration of their interest-free grace period, and thus pay no interest at all on their credit card accounts. Almost half of all consumers affected by such legislation, therefore, would not realize any benefit; they would, instead, be adversely impacted, as discussed below.

A. A Credit Card Interest Rate Cap Would Adversely Affect Consumers By Limiting Availability Of Credit And Discouraging Interest-Free Grace Periods.

It is far more costly to administer a credit card program than comparable consumer lending programs. A bank that makes a consumer loan incurs only the administrative costs of processing an application, extending the loan, and issuing a coupon booklet. For the credit card issuer, the processing and approval of an application and the mailing of a credit card is only the beginning of a continual process of extending credit, authorizing and clearing transactions, and processing and sending statements. The difference between interest rates currently charged on many consumer loans and the interest rates on credit cards is, to a large extent, attributable to these extraordinary costs.

Because declining interest rates do not affect these fixed administrative costs, an artificially-imposed credit card interest rate cap will force credit card issuers to attempt to cut costs elsewhere. Credit card issuers will likely attempt to reduce their costs due to write-offs and losses, and cease

issuing credit cards to applicants with low and moderate incomes, and young applicants without established credit ratings. Credit card issuers may also be forced to reduce or eliminate grace periods for most cardholders, thus taking away access to interest-free credit currently enjoyed by 47% of all cardholders.

B. A Credit Card Interest Rate Cap Would Have An Anti-competitive Effect On The Credit Card Industry.

The credit card industry is currently fiercely competitive, dominated by no single issuer, and no single type of credit card or charge card. New issuers are entering the market at increasing rates, encouraged by the drop in interest rates. Existing card issuers are introducing new features to attract new customers, and are, indeed, already lowering their interest rates in response to increasing competition. To impose artificial price controls on a market as competitive as this would discourage the free market forces that are currently at work, and would almost certainly have an anticompetitive effect.

An artificial ceiling on credit card interest rates would discourage new issuers from entering the credit card market. Moreover, the restrictive usury laws of the late 1970s and early 1980s demonstrated that artificial interest rate caps can cause existing card issuers to drop out of the market altogether. As a result, the total number of credit card issuers is likely to decrease. In addition, the existence of artificial price controls in any market provides a strong disincentive for further price competition. The card issuers remaining in the market will have no incentive to follow natural market tendencies to drive prices down, since free market forces will have been subjugated to statutorily-imposed limits. As a result, credit card interest rates are likely to settle uniformly at the rate imposed by statute, eliminating any price competition between credit card issuers.

We firmly believe, therefore, that a statutory cap on credit card interest rates will harm consumers, by forcing credit card issuers to restrict availability of credit cards to consumers with high incomes or established credit ratings and eliminate costly features such as grace periods, and reduce competition among credit card issuers. We emphatically urge this Subcommittee to reject any legislation imposing a cap on credit card interest rates.

II. DISCLOSURE LEGISLATION.

The CBA supports legislation to require the disclosure of principal terms applicable to credit and charge card accounts in all applications and solicitations mailed directly to consumers. We believe that consumers should receive information regarding essential account terms early enough in the process of

selecting between competing credit and charge card plans to enable them to make informed choices between the various plans. We further believe that the scope of this disclosure information must be sufficiently limited to enable consumers to understand and easily compare competing cards, and to encourage consumers to actually make the effort to do so.

We therefore strongly support the proposal introduced in the House of Representatives by Congressman Doug Barnard of Georgia, H.R. 1086. The Barnard bill would require all applications and solicitations for credit and charge cards which are mailed directly to consumers to disclose the principal terms of any credit plan: the annual percentage rate, the annual fee, and the existence of a grace period. We urge this Subcommittee to reject the more complex disclosure requirements of S. 241, S. 616 and S. 647. As explained below, we believe that each of these proposals would impose excessive and counterproductive disclosure requirements on card issuers, while at the same time discouraging consumers from engaging in comparison shopping. Nevertheless, if the Subcommittee determines to impose requirements for take-one applications or magazine advertisements, we urge that card issuers be required to provide only an address or telephone number where consumers can obtain the new disclosure terms required for other applications.

A. Additional Credit Card Disclosure Legislation Should Apply Equally To All Credit And Charge Card Issuers.

Unlike the Barnard bill, the three Senate bills do not apply equally to solicitations and applications for all charge card and credit card accounts. Both S. 241 and S. 647 would apply only to credit card accounts and would exclude charge accounts. Moreover, S. 647 would apply only to credit cards offered by banks. Although S. 616 contains provisions applicable to charge cards, it would apply only abbreviated disclosure requirements to charge cards providing access to extensions of credit under open-end consumer credit plans, and would not permit the consumer to determine in advance the key terms applicable to that consumer credit plan, or the identity of the creditor providing that plan.

We do not believe that consumers who wish to engage in comparison shopping can do so effectively unless they are presented with equivalent information concerning all competing consumer credit plans. Currently, bank credit cards make up less than 20% of all card plans, and credit cards issued by non-bank lenders, including retailers, are basically indistinguishable from bank-issued credit cards. To deprive consumers of comparison shopping information with respect to 80% of the card market would be inconsistent with any consumer protection contemplated by the proposed new disclosure legislation, as well as unfair to bank card issuers that must compete with such other card plans.

Senator DODD. Thank you very much, and I thank all three of you for your statements, and as I said a moment ago, we will see that all of your charts and whatever else are made a part of the record for other members who may want to look at them.

Let me begin, I guess, with you, Mr. Craft, since we started with you. Correct me if I overstate your case at all, but as I understand it from your testimony, you oppose disclosure on the Take One applications. Of course, as we both know, many people do apply on those applications. I wonder why you would distinguish there, since we all agree, I hope, that what we ultimately want to come out of here with, in terms of the language of the disclosure, clear and concise, so that it actually does contribute. I don't want to see a lot of complicating language. I think that many of you who have said so—Mr. Rohner, you just mentioned it—and I agree with you. I think you have a self-defeating result, if you make it too complicated. I think the consumer just gets turned off by it immediately, in a sense, but I don't know why you would make the distinction, Mr. Craft, between your open solicitation and Take One. Why not just put it on there as well? What is the reason for not doing that?

CONFUSING AND MISLEADING

Mr. CRAFT. We serve 1.9 million VISA and MasterCard holders. Nine out of every 10 of those, we obtain through the mails, not the Take Ones. We have 35,000 to 40,000 merchant locations around the country where our applications may be displayed. We don't think that it is appropriate to mail them out, when some of them may not be replaced for 2 or 3 years, and when we do not know in 1987 what interest rates will be in 1990. We are afraid that those disclosures that we would put on there might be more confusing and misleading than helpful.

Senator DODD. Well, the other one it would seem to me—putting aside the balance calculation, would be the annual rate. Someone suggested that you should—that there is a way to handle that. One of the issuers' complaints, of course, is that things do change. Possibly there could be some provision in there to check on the annual rate. It was this amount, but you should check that. This is what it has been. I mean, there is a way, it seems, in which you could accommodate that.

Mr. CRAFT. If there were a disclaimer in something that consumers would use, I would question whether the consumers would really use that, if they saw the disclaimer. I am concerned that consumers be helped. I am not sure with the Take One brochures that are in all of the merchant locations that that is an appropriate place for specific disclosures. Perhaps the bill could require that a number be listed in the Take Ones, where they could call for the pertinent rates, but not actually require that the disclosure be a part of the brochure itself.

Senator DODD. Well, we will chat with you on that and talk to people, because I do think that is a problem that we have got to overcome. I appreciate your concern about it, in terms of the printing and getting those things around all over the country.

Let me mention, as well, and I will address this to all of you, because you have all, to one degree or other, discussed the method of

calculating the balance. You mentioned, Mr. Craft that it doesn't make that much difference in terms of the bottom line charge to the consumer. I appreciate that. As I understand it, it probably doesn't. My concern about it would be this. Let me just try and state it as clearly as I know how to. That while it doesn't right now, I appreciate the fact out there there are good smart people and the job of these companies, as it should be, is to return a profit. This isn't the Peace Corps program. This is to make money. And you leave a hole open in this disclosure area on the grounds that it is a little too complicated for people to understand, and I appreciate that it is complicated, but my concern, as a legislator here, where we all agree on the importance of disclosure, so that people can make intelligence choices, so that, frankly, we get a rate that is realistic—I am not going to say necessarily lower or higher, but one that is realistic.

You take away an element that could have a very significant impact, if cleverly used, so that despite the fact that you have disclosure of the annual percentage rate, disclosure of the grace period, disclosure of the annual fees, and we leave out calculating the balance, I can see some very smart lawyer or accountant someplace saying, we can drive a Mack truck through that one, and virtually change or regulate or determine ourselves on a fluctuating basis without the consumer ever really being involved. And say later, look we're sorry, but that calculating balance allowed us to do this, that, and the other. We didn't have to tell you that.

That is what my concern is by leaving that out. I understand the fear of putting it in. My concern is, leaving it out, you get what I've just described.

CALCULATING THE BALANCE

Mr. CRAFT. Of all the average balance computations that I have seen, the only one that makes a real difference involves the grace period, where it is a matter of taking the grace period away on a retroactive basis. And there may be a positive way to deal with the issue, which is much the way we attempt to deal with it. And we do not use the average daily balance on a retroactive basis. We are using strictly a more standard average daily balance, not that there is a pure standard, but we simply say no finance charge will be assessed on purchases when you pay your balance in full each month. And I believe that still would be true under that average daily balance computation.

Consumers comprise two markets, those that are looking for something they can pay in full each month, which one-third of consumers will do on a monthly basis and those that extend charges, where they are more concerned with a lower APR than they are with the average balance computation method.

Senator DODD. Do both of you want to add a comment on that?

Mr. ZOROYA. I think one of the things that concerns NRMA and the smaller retailers it represents, is the difficulties they would encounter in trying to comply with such a requirement because they generally are not fully computerized.

Senator DODD. Well, I appreciate that. That is why I pressed that.

Mr. ZOROYA. That is one of the problems.

I agree that there should be disclosure of whether or not there is a grace period; that is really one of the major differences between most of the systems that are being used today. But there is no need to disclose balance method. If you take the previous balance method, and you take the average daily balance method, the bottom line difference is less than 2/10 of 1 percent. They are almost identical. So it really isn't as important to the consumer as knowing whether or not he or she has as a grace period. I agree with that.

Mr. ROHNER. Mr. Chairman, if I may add to this. The question is not whether the disclosure of the balance ought to be made. It will be made with the initial complete set of disclosures that will be made with every periodic statement thereafter. The question is only whether it can and should usefully be made up front.

Senator DODD. Yes, that is a good point. Yes. Good point.

Mr. ROHNER. Another reason why it perhaps doesn't belong there, is that it is uniquely subject to actual transaction use patterns on the card, and the consumer looking at it in advance, will be trying to make an abstract about how it would work.

Senator DODD. That is a good point. I appreciate your making that.

MARQUETTE DECISION

The *Marquette* decision. You have heard it discussed at some length here today by, I think, almost every witness. I wonder if each one of you might comment. And Mr. Rohner, I don't want to put you in an awkward position, because I read with great interest your 1979 article on that, but all of us wear different hats and have different functions to perform. I am not trying to play games with you at all. You may have a different view today, and I will give you a chance to comment.

Why don't we start with you, Mr. Craft?

Mr. CRAFT. No. 1, it would restrict competition, because there would be fewer issuers——

Senator DODD. I am sorry, you are for not——

Mr. CRAFT. I am for leaving the *Marquette* decision as it stands today. We would oppose any ceilings at the Federal or the State level. We feel the free marketplace can work at the Federal and the State level as efficiently, No. 1. We also feel that if any reasons to oppose ceilings which we listed in our testimony, are applicable at the Federal level, they are also applicable at the State level. We would clearly see a restriction of credit in various States. We would see a much more complicated system that would have to comply with 50 different State legislatures as opposed to one. We would increase the administrative costs of delivering the product.

We also would see a restructuring. I would not be surprised to see credit cards offered as a package of total consumer financial services rather than just a credit card, because offering a credit card with some of the numbers that have been shared on the panel today, perhaps doesn't have all the profits and all the business cycles that——

Senator DODD. Well, let me ask you this. I mean, it is in regards to the ABA you represent. One of the difficulties that the ABA has as an organization is that it is such a diverse crowd. I mean, you've got the people who are the largest banks in the country and those who are real small banks, and it is all under the umbrella of the ABA. I don't envy the position you are in. Unlike most organizations, you have got real diversity, and there is as much in-fighting as goes on, I know, in trying to set a position with the ABA, as probably any organization in the country.

Now I understand what you are saying and I appreciate it. I mean, the fact is that you and I probably agree. I don't like the idea of setting these arbitrary rates and caps on these things, but I think you would agree, probably, if it is going to be done, it probably ought to be done at the State level rather than at the Federal level, because there is diversity, certainly, in the country, and trying to pick a national floating level creates a quagmire of bureaucracy, it seems to me, in trying to deal with consumers effectively. But you've got an awful lot of small banks out there that get whacked by us, because they get covered by it. They don't have the diversity to build an export and move the operations out of State and then go back and sell a card inside.

What do you do about that?

Mr. CRAFT. Senator, we all have our challenges daily and that is something that we work on very hard at the ABA is presenting a uniform opinion. We still have some room for perfection on that issue, and I would not say that there are not bankers that might favor looking at *Marquette* differently, but I could say, as a representative of the credit card part of the ABA, which is one part of it, that we are very unanimous in our opinion, in terms of the bankers that I talk with. I think that it might be some of the banks that aren't issuing the credit cards and perhaps have elected not to play in a very competitive environment that feel that way. We feel, if it is their decision not to be competitive in the marketplace and issue credit cards, only 4,000 of 14,000 banks do, perhaps those that don't issue credit cards on a proprietary basis, may feel differently.

Senator DODD. OK.

Mr. ZOROYA. Actually, the issue is more relevant for vouchers than for retailers.

Senator DODD. Well, you are covered by when States pass——

Mr. ZOROYA. Oh, yes.

Senator DODD. So you are hit by it. In other words——

Mr. ZOROYA. A change in it, I don't believe would affect retailers directly, as I understand it.

Senator DODD. Yes, I think you are. In Connecticut, I think you are. So you would oppose legally changing the *Marquette* decision?

Mr. ZOROYA. My understanding is that we are charging the rates in the states in which we are doing business. We don't have a national rate that we export to another——

Senator DODD. No, I understand that, but I am wondering whether or not you think that decision ought to be overturned by statute.

Mr. ZOROYA. Well, NRMA doesn't have a position on the *Marquette* decision at this time.

Senator DODD. I guess you don't feel—I thought you were going to tell me you felt discriminated against, which——[laughter].

Mr. ROHNER. I've gotten older and wiser since 1979. [Laughter.]

The Consumer Bankers Association would, I think, oppose a reversal of the *Marquette* decision, in general, but particularly as it would apply to credit card lending. I think part of our observation in that regard would be to remind the committee, I think that the implications of *Marquette* involve all forms of bank lending. They involve interpretations of Federal banking laws that go back more than a century, that it is simply not a project lightly undertaken without full appreciation for the implications of it. I think it is also possible, Mr. Chairman, to say that a reversal of *Marquette* would be distinctly anticompetitive. At the moment, if a bank opts to export higher rate credit card programs into a particular jurisdiction, is the appropriate cure for that to prohibit that bank from exporting in those higher rates or to encourage local banks to compete at the rate and other term aspects of their own offering and win the battle of the competitive level rather than a legal, realistic level.

Senator DODD. I agree with that. Sometimes, unfortunately, some of the larger entities are in a capacity or have the capacity to reach more consumers. They have greater capital resources, with which to advertise than the small institutions. So there is a number of other things that can be done. So it is somewhat of a disadvantage. But I appreciate the fact that possibly with disclosure that that may become less of a problem. My own inclination is probably to try the disclosure out, keep that out at this particular juncture and see how things go, rather than assuming that we have got to deal with that problem simultaneously.

Don't hold me to that, but that is sort of the direction I am leaning in after listening to today's testimony from various people on the issue.

RETAILERS LOSE MONEY ON THEIR OWN CREDIT CARDS

Mr. Zoroya, you cite in your testimony that retailers never make money off their card stores. Why don't you just abandon them and accept bank cards?

Mr. ZOROYA. Well, the main reason we don't is because our credit card customers are our very lifeblood. We do about 60 percent of all of our business with our credit card customers. If we were to abandon that, we would lose one source of business that would be very, very difficult to replace.

Senator DODD. But you are losing money on the cards?

Mr. ZOROYA. We are losing money on the cards. What we would like to do is at least break even. I think even those retailers who tend to make a little money on their credit operations as a percent of their total, see a very, very small return. We would like to have the credit customer, who wants a particular service, be able to take advantage of that service and pay for the cost of that service. That is what finance charge revenue is. If we could reach a zero number where that credit customer were paying for that service, we would feel very good about it.

Senator DODD. But obviously, it is, overall, the credit cards have been good for business.

Mr. ZOROYA. Oh, yes.

Senator DODD. In your operation.

Mr. Rohner, in your testimony, you point out that about 47 or almost 50 percent of the people pay off within the grace period and their effective annual percentage rate is basically zero then for these people. And they're called, I guess, in the credit card business the "free riders," those you don't make any money of. So roughly 50 percent, the other crowd, it seems to me, are those who are subsidizing the free riders. Is there a factor that is built into these numbers that we are hearing about today that really tries to pay for the free rider? The person who pays off their amount each month, and the person who doesn't is actually being charged a rate higher than they would, to compensate the free rider, the cost of handling the free rider. And if so, how much?

Mr. ROHNER. I can't give you a precise figure, but I think the fact that there has been some degree of subsidization of one part of the customer base by another over the years is undeniably true.

Senator DODD. I'm sorry?

Mr. ROHNER. I think that is undeniably the case over the years. So I think that is precisely why you begin now to see banks and other card issuers starting to break out their charges into other components. The annual fee is the most obvious example. I may pay off my balances every month, but I pay that annual fee and produce that revenue for the card issuer, notwithstanding. That movement now starts to include transaction fees and other forms of charges.

Senator DODD. The so-called "enhancements," the insurance stuff we heard about earlier, for instance, along that category.

Mr. ROHNER. Yes, I think so. And it attempts, I think, to distribute the cost burden among the customers, more or less as they use those services.

Senator DODD. It would be interesting—do you know where we might go to—maybe the ABA—maybe you are the crowd I ought to ask. I would be curious about that. If you could take that 47 percent figure, I would be interested to know to what extent the interest rate is affected by the free rider.

Mr. CRAFT. Senator, let me try that question, if I could. What I see in my portfolio is about 45 to 50 percent of the volume each money is represented by those consumers that pay in full. They are charging more than the average consumer and only make up about one-third of the statements that we render; however, that consumer on a velocity each year will turn over his outstanding six times. He may have $500 outstanding and make $3,000 in charge purchases. We do receive about 2 percent, not 8 percent from the merchant. So we have 2 percent times that volume. We also receive the annual fees, in terms of those consumers that are revolving, they turn over their balance a lot closer to 1 to 1½ times a year. So you don't get the merchant discount. So while it is a complicated business, there are some balances within the system that give us some revenue on those consumers. And if you look at that consumer on an incremental basis with the velocity with the annual fees, you can satisfy yourself that you are really not subsidizing that consumer.

The other thing that many banks have done, and we attempt to do it, and it has been brought up earlier this morning, involves de-

linquency fees. We attempt to recoup some of our costs of delinquencies from those consumers that are going delinquent. Well over 9 out of our 10 customers do not encounter any type of fee other than the three basic ones we feel should be disclosed. We attempt to have those consumers pay their fair share of the load of those expenses. We don't make a profit on those fees. We try to recoup some of our expenses.

I hope that is helpful.

Senator DODD. That is very helpful, and I appreciate that. Did you want to comment on that, Mr. Zoroya?

Mr. ZOROYA. I want to comment. People pay in full, but they are different customers. Some of our customers take advantage at sometime of the year of revolving credit and sometimes they take advantage of paying in full. One of the reasons that our accounts are so attractive to especially the middle and lower income customers is that having the account enables them to take advantage of saving more money on sale items, among other reasons. And in return there is the minor cost of an average $28 total finance charge, everything combined, per year. If a lady sees a coat that is on sale for $40 that is regularly $70, and she can save $30, she may not have the $40 to pay for that coat, but if she can charge it to her account, she will save more than whatever the finance charge cost her. So our customers will use the account part of the year as a 30-day account and part of the year as a revolving account. And only a portion of the cost that is being subsidized by the so-called "30-day pay account" is the cost of money which, in our case, is only about half of our total cost.

Senator DODD. Well, that is very helpful.

Senator Exon, I don't know if you have any questions for these witnesses.

Senator EXON. A general question or two, gentlemen.

I came out of the loan and finance business early in my career, so I have always had a keen interest in this whole matter of what we do with credit.

All the statistics I have seen indicate an explosion, a continuing explosion of consumer credit. Is it still increasing substantially each and every period, or has it begun to level off?

CONSUMER CREDIT

Mr. CRAFT. We have seen a leveling impact and much of the credit that gets assigned to credit cards is not appropriate. Less than 10 percent of the nonmortgage and only 4 percent of the total consumer debt in the United States is on credit cards, on bank credit cards. So we tend to be the culprit, but I believe that we are getting more credit than we truly deserve for that particular area.

Much of the expansion has been in the installment area from my perspective, in regards to financing automobiles where consumers have been encouraged to take on debt when they really may have the cash, because of some very, very attractive financing. So I believe that some of that debt is overstated.

We also saw a moderation in 1986 in the growth of credit cards at almost 60 percent of what the growth had been the prior 4 years. So there are signs that it is a more mature industry.

Similarly, charge cards which offer access to a related line of credit from a creditor selected by the charge card issuer are indistinguishable from typical bank credit cards. Holders of these cards can repay in full each month and avoid finance charges, or repay in installments (through access to the standby line of credit) and pay a finance charge. From the viewpoint of the consumer, such a program is the functional equivalent of a credit card. Therefore, we believe that consumers should be supplied with the same information concerning charge card plans, and at the same point in time.

We therefore oppose the approach taken in S. 241 and S. 647, which would exempt such cards entirely from any new disclosure requirements, as well as the approach taken by S. 616 which would not require the disclosure of such information until after the consumer has applied for and received his or her card. We recommend, instead, the language of the Barnard bill, which would impose the same disclosure requirements on credit cards and charge cards providing automatic access to open-end lines of credit. With respect to other charge card plans, applications should be required to include a telephone number or address where a consumer can obtain any new required disclosure terms in advance of completing and submitting an application for the contemplated charge card account.

B. Additional Credit Card Disclosure Legislation Should Apply Only To Direct Mail Solicitations.

S. 241 and S. 647 do not distinguish between direct-mail solicitations and applications which are generally available at branch, merchant and other locations. S. 616 does make such a distinction, but actually imposes additional burdens on applications other than those mailed directly to consumers. We urge this Subcommittee to reject both of these approaches, and to adopt instead the approach of the Barnard bill, which would limit new disclosure requirements to applications and solicitations included with "written material mailed directly to the consumer by name."

The criticism of credit and charge card practices motivating the current Congressional proposals for additional disclosure requirements stems in large part from the increased use of direct mail marketing techniques by card issuers since the passage of the Truth in Lending Simplification and Reform Act in 1980. The CBA readily agrees that applications and "pre-approved" solicitations for credit and charge card accounts sent directly to a consumer's home should include information concerning key terms applicable to such accounts. The same degree of concern has not been expressed, however, regarding applications available from display racks in merchant shops or restaurants, or applications included in magazine advertisements.

In addition, the imposition of new disclosure requirements for take-one applications or magazine advertisements, as would be mandated by S. 241 and S. 647, would result in significant compliance burdens for card issuers. Moreover, S. 616 would impose further disclosure requirements for take-one applications and would cause additional operational problems for card issuers by requiring that all information disclosed on such take-one applications be "accurate as of the date the applications are distributed to the commercial retail establishments." Because card issuers often print thousands of applications at a time and frequently distribute take-one applications through third-party service organizations, however, dating and accuracy requirements keyed to merchant distribution schedules would be virtually impossible to satisfy, and would greatly increase printing costs -- particularly for smaller card issuers.

In particular, card issuers must print take-one and magazine applications in bulk to take advantage of discount printing rates. Credit card terms can change frequently, however. Reprinting applications to conform to every change in terms and resupplying all public locations where such applications are available to consumers would be an impossible task. Furthermore, smaller card issuers could no longer print their applications in conjunction with other issuers, to save on printing costs. Card issuers that use different terms in different states, based on the residence of the cardholder, would be required to distribute different applications in each state or to include long and complicated explanations of the possible terms, making quick and easy comparison shopping more difficult.

For all of these reasons, we urge this Subcommittee to limit additional disclosure requirements to direct mail solicitations. Nevertheless, if the Subcommittee determines to impose requirements for take-one applications or magazine advertisements, we urge that card issuers be required to provide only an address or telephone number where consumers can obtain the new disclosure terms required for other applications.

C. Disclosure Should Be Limited To The Most Meaningful Terms For Comparison Shopping By Consumers.

Consumers already receive complete disclosure of fees, charges and conditions imposed in connection with credit card accounts prior to becoming obligated to the card issuer, as required by the existing Truth in Lending Act. New disclosures should not substantially duplicate the initial disclosure statement terms. On the contrary, if a quick and simple method for comparative shopping is the goal, required information should be kept to the absolute minimum. It should focus on the most obviously "shoppable" aspects of the credit plan, those that will always affect the consumer's costs.

Therefore, CBA recommends that any new disclosures be limited to the three principal credit card terms contained in the Barnard bill: the annual percentage rate or rates, the annual fee, and the existence of a grace period. In particular, the legislation must avoid terms which would require a narrative description or explanation by the card issuer, such as the balance computation method (which would be required by S. 616), a specific description of the length of the grace period (which would be required by S. 241, S. 616 and S. 647), or explanations of every possible charge that could be imposed under the card plan (which would be required by S. 647).

Since the stated purpose of an early disclosure requirement is to allow quick comparisons among competing card accounts, requiring disclosure of terms that must be described or explained in extended narrative form would be contrary to the goals of the various disclosure bills.

1. Annual Percentage Rate.

CBA considers the annual percentage rate to be a key term in a consumer's selection among competing card accounts, and supports its disclosure at the application stage. All three of the bills before the Senate would require disclosure of the annual percentage rate. Any disclosure requirement with respect to such rates should, however, accommodate card programs with variable interest rates, which may change after a solicitation has been mailed. This could be done by allowing card issuers offering variable rates the alternative of disclosing the manner in which the variable rate or rates are determined. Specifically, such a disclosure provision might allow the card issuer to identify the index and the spread used to determine the rate.

Of the three Senate disclosure bills, only S. 616 specifically addresses the issue of variable rates, requiring the disclosure of both the means for determining the variable rates and the range of balances to which the rates are applicable. The Barnard bill, however, would provide greater flexibility in disclosing variable rates by giving the card issuer the option of disclosing either the rate or rates as of a specified date, or the means or index for determining the rate. We urge this Subcommittee to adopt this more flexible provision, since the same essential information will reach the consumer under either method of reporting a variable rate.

2. Annual Fee.

S. 241 would require the disclosure of "any annual or other charge or fee required to be paid for the use of the credit card account" (emphasis added). S. 516 would require the disclosure of "[a]ny annual or other fee or charge imposed for the issuance or use of a credit card" (emphasis added). S. 647 would require the disclosure of "any annual or other periodic fee" (emphasis added).

It is not clear from the legislative language what the terms "other fee," "other charge" or "other periodic fee" means in these bills. As used in existing Section 127 of the Truth in Lending Act, disclosure of "other charges which may be imposed as part of . . . [an open-end credit] plan" means disclosure of all charges other than finance charges. Regulation Z also uses the phrase "other charges" to mean "any charge other than a finance charge that may be imposed as part of . . . [an open-end] plan." 12 C.F.R. § 226.6(b). Such an interpretation would require, for example, the disclosure of such fees as late charges, overlimit fees, overdraft fees, application fees and default charges, if such fees are "applicable" to the use of the card.

It is even less clear what "any other fee" is intended to mean, since this term is not addressed under the existing law. As a result, "any other fee" could be interpreted as requiring the disclosure of all other account terms which may result from the use of the account, including all finance charges.

Either interpretation would greatly increase the length of any resulting disclosure and would complicate any effort to comparison shop by introducing numerous fees and charges other than a traditional membership or participation fee. This result clearly could not be intended by the sponsors of the legislation being considered by this Subcommittee. We therefore recommend that any new legislation include language requiring the disclosure of "any annual or periodic membership or participation fee that may be imposed for the availability of the account."

3. Grace Period.

S. 241 and S. 616 would explicitly require the disclosure of the length of any grace period applicable to a credit card, or the fact that no such grace period exists. S. 647 would require the disclosure of "any grace period," without any further explanation.

The grace period disclosure language contained in S. 241 and S. 616 is similar to the language in Section 127(a) of the existing Truth in Lending Act, which sets forth the more comprehensive disclosure requirements for initial disclosure statements. Thus, this provision could be interpreted to require a lengthy explanation of such features as the method of posting debits and credits to the account, and forgiveness periods permitted under federal law to accommodate mail delays, as well as distinctions between grace periods for purchases and cash advance transactions permitted or required under state law. Any such discussion or explanation would greatly complicate the grace period disclosure and limit its usefulness for comparative shopping. We therefore urge adoption of a provision such as that contained in the Barnard bill, requiring disclosure of the existence or lack of a grace period only.

We also support the Barnard bill's limitation of any disclosure requirement with respect to grace periods to purchase transactions. Purchase transactions are, by far, the most common credit card transactions. As a result, consumers are much more likely to be concerned with grace periods applicable to purchase transactions than with those applicable to cash advance transactions. Indeed, most consumers do not expect grace periods when receiving cash advances, since card issuers seldom supply such grace periods in connection with cash advance transactions. Limiting disclosure of grace periods to purchase transactions would simplify the content of the disclosure, provide consumers with the most useful grace period term, and increase the likelihood that consumers will in fact use the information for comparison shopping.

D. No Particular Disclosure Format Should Be Required.

S. 616 would require card issuers to provide the mandated disclosure information in a tabular format. S. 241 and S. 647 contain no similar format requirement. CBA firmly believes that card issuers should have the flexibility to provide any required disclosure information in a manner which best fits the particular card plan and disclosure circumstances. A "clear and conspicuous" standard, as currently mandated by the Truth in Lending Act, should be sufficient in connection with any new application disclosure requirements.

The tabular format requirement of S. 616 would lead to costly litigation and liability for card issuers as a result of technical format violations. It was exactly this type of technical litigation which led Congress to enact the Truth in Lending Simplification and Reform Act of 1980, which replaced similar technical requirements with the more flexible "clear and conspicuous" standard. The Subcommittee should not ignore this history in considering new application disclosure requirements.

E. Preemption Of State Law.

The intention of the various disclosure bills being considered by the Senate is to provide consumers with a concise, uniform disclosure of the key credit terms, in order to facilitate comparison shopping among card accounts. To achieve this goal, it is important that individual states not be allowed to vary either the content or the circumstances of application disclosure requirements. Complete federal preemption of any state application disclosure requirements is essential.

Neither S. 241 nor S. 647 contains any provision for the preemption of state laws. S. 616 does include a state law preemption provision, but the effectiveness of this provision is questionable. More specifically, S. 616 provides that state law is not preempted if "the law of the State explicitly requires the disclosure of such information in a credit card application or

solicitation." Because any state statute imposing disclosure requirements in connection with credit card applications is likely to satisfy this limited standard, the federal preemption provision of S. 616 could preempt very little state law. As a result, the objective of uniform application disclosures would be totally frustrated by inconsistent state laws. Therefore, a stronger federal preemption standard, like that contained in the Barnard bill, is essential.

F. Transition Period.

Any legislation to impose new disclosure requirements in connection with credit card applications must provide an adequate transition period for the promulgation of Federal Reserve Board regulations and the preparation of card issuer compliance provisions.

S. 241 includes no transitional section. Both S. 616 and S. 647 include a delayed effective date. It is not clear, however, that either bill would provide sufficient lead time for the promulgation of regulations and the completion of compliance efforts. In addition, neither bill would permit early compliance by card issuers who are able to do so. Thus, we recommend that any new Senate disclosure legislation provide a transitional period of at least 270 days, as provided in the Barnard bill, and permit card issuers to comply with any new disclosure requirements as soon as they are able to do so.

Senator EXON. I didn't mean, Mr. Craft that I was talking to you as a banker. Everybody is tempted to focus in on their narrow field. Certainly, it is now easy to use a credit card. I have been amazed to see people do so. They will be right before me in Hechinger's—that is about the only store I shop in. [Laughter.]

I pay cash. I don't have a Hechinger card. But it does bother me greatly. You know, I get a little upset every time I see people who use credit cards. It has to cost Hechinger's, or whatever card it is, something. They pay the same price for a box of nails as I do, you know. And it just rankles me, when you talk about free riders a little bit. The people who are penalized today in the retail area, by and large, are the people who pay cash; is that correct?

Mr. CRAFT. I view that the credit card purchases much like retailers do. They support sales and increase sales. Without the credit card, you would not have the economies of scale for the retailers that you have today, and the general economic activity without credit in the United States would be curtailed. I am not sure that on a percentage basis that we would be more efficient than we are today at lower volumes.

Mr. ZOROYA. That is one of the things that really concerns us in retailing.

Senator DODD. Do you have a cash discount?

Mr. ZOROYA. No, we don't. But we are seeing another alarming trend in retailing right now. It has been going on now for at least 15 years. I am from Omaha, NE, orginally, and I worked for the biggest department store in Omaha. I am sure you know which one that is. Twenty years ago, we did about 53 percent of our business on credit. Today we do about 60, which is not an explosion from the standpoint of how much the retailer is doing on credit, but what is happening today that concerns us a great deal is, there is a huge transfer of retail credit out of department stores. It started about 15 years ago, and we had a study done that showed that retailers were losing money, which we all were. And so it encouraged a number of retailers to move into the third party card and get rid of their own systems.

Thus, some of these credit sources have dried up. You very seldom see small retailers who have their own credit system anymore. You don't see very many medium-sized retailers that have their own credit systems and the big ones now are beginning to fall. You see Macy's and the May Company and Federated. Many of their stores are beginning to accept third party cards. What that is doing is moving the consumer credit out of the department store and into third party cards.

I am not sure that is a healthy trend, but if it becomes so restrictive for retailers to continue doing their own credit business, and we desperately want to continue to extend credit, it could eventually move all of it into third party credit. That is certainly the trend that is going on in this country.

Senator DODD. Well, there are—I remember, Jim, I think one of the first—in fact, the first bill I ever got involved with here 7 years ago was the debate on the credit card, the surcharge, and the penalty issue raised in here and on the floor, and I—we see gasoline stations do it, where you get a cash discount and——

Mr. ZOROYA. Actually, Senator, retailers, orginally, back in the turn of the century, built their business when they went to a one-price system. I think it was a Mr. Lazarus who may have started it, if I am not mistaken. And it was his philosophy that says, everybody ought to be able to come into that store and pay the same price for the same merchandise rather than negotiate for every piece of merchandise. And retailers have pretty much stuck to the one price-system for all those years. And I think consumers appreciate the fact that they are not going to pay any more for a piece of merchandise on credit than someone else who buys for cash.

Senator EXON. Do you think Hechinger's have a one-price system when they charge me the same amount of money for cash for a box of nails as they do for someone who puts it on a credit card?

Mr. ZOROYA. Oh, yes, because the person who puts it on a credit card is going to pay a finance charge for the use of that account.

Senator EXON. Oh, he pays a finance charge for that.

Mr. ZOROYA. Yes.

Senator EXON. Oh, I don't have a Hechinger's. I assume that if they paid that within 30 days, they didn't have any charge?

Mr. ZOROYA. That is correct. But what we are saying is that, of the people who have charge accounts, they all use revolving credit from time to time. So you can't say he's per se a 30-day customer who always takes advantage of the 30-day credit.

Senator EXON. Well, he gets an advantage over me, who pays cash, doesn't he? [Laughter.]

Mr. ZOROYA. For that particular month, he does. And you, as a cash customer is subsidizing part of his credit service. The reason you are subsidizing it is because we are coming out at a loss at the end of the year.

Senator EXON. Well, my follow-up question was, Mr. Chairman, and then I will be quiet, what is the difference in loss between credit card sales and bad check sales? I don't know if you have ever tried to write a check for anything in this town. But regardless of who you are or anything else, you know, they suspect. That plastic thing comes in there, that plastic thing is it.

Mr. ZOROYA. Right.

Senator EXON. If you show them all kinds of credentials, pictures, identification——

Senator DODD. Don't ever show them your Senate ID! That's automatic——[laughter].

Senator EXON. I know.

Senator DODD. They just reject you out of hand!

Senator EXON. They know we're a bad credit risk. And the reason for that is that some my colleagues have lousy credit records—[laughter]—or don't have any money in their checking account.

Senator DODD. That's why I am holding these hearings. [Laughter.]

Senator EXON. Do you lose more money on bad checks than you do on bad credit cards?

Mr. ZOROYA. Well, it depends on the industry.

Mr. CRAFT. I don't have specifics on the industry, and I don't know. It is something that we will be glad to research, but I would like to say that your credit card is good in far more places than is your check, both in the United States, in various States, and abroad, anyplace in the world than the local currency. So the payment service device of a credit card today, whether you are checking into a motel or catching a cab and getting some cash in Canadian dollars is a very valuable financial tool for consumers that they have grown to love and appreciate and use tremendously. That check will not serve the same functions.

Senator EXON. No, well, back to my question——

Mr. ZOROYA. In retailing, we charge about twice as much on bad debt as a percent of sales as we do on bad checks, and the reason for that is because we do so much more business on our credit cards than we do on the checks. Also, we have to be more restrictive with purchases by check. One of the reasons is because we don't have the control over checks that we do over charges. If a customer comes into our store today and charges $1.98, we know that it goes to his account immediately. We know what his balance is immediately. We know how close he is to his limit. But when the fellow comes in with a check, where is he going to present it? What kind of credentials does he have and how easy is it today to duplicate false credentials and false checks?

We have seen some geniuses in this area that——

Senator EXON. Well, they can do it with credit cards too, can't they?

Mr. ZOROYA. Not as easily.

Senator EXON. Not as easily?

Mr. ZOROYA. No, it isn't as easy.

Senator EXON. Thank you, gentlemen. Thank you, Mr. Chairman.

Senator DODD. I thank all three of you. It's been very helpful, and I mean that. Your testimony is helpful, and we will be looking to you again in the coming weeks, as we go back and, based on today's testimony, work on modifications in the bill and the like to address some of the concerns and very significant and helpful suggestions you have made in a number of areas, at least in my bill.

I would say to the three of you, I get the sense here today—with people who normally have significantly different opinions, I get the sense here that this committee would be more inclined to move on the disclosure front rather than the cap front.

Mr. ZOROYA. Senator, could I raise one more comment?

Senator DODD. Certainly you can.

Mr. ZOROYA. I am sorry to hold it at the end, but it just occurred to me. We do a lot of credit promotion and sometimes we are questioned for doing credit promotion, because they think we do it maliciously or we do it without controls. An average department store today loses 15 percent of its accounts every year. So just to hold our chins even with the water, we have to replace that 15 percent every year. That is the reason we have to go into some of these solicitation programs, in order to maintain our customer file. I

wanted to make that point, because it isn't just a matter of proliferation of credit. It is replacement of credit, if you will.

Senator DODD. I appreciate that. What I think, you know, and I would hope that we are here talking about how best to deal with this, is the issue of the high cost. I don't think it has been stated enough here probably, and I should have probably stated it at the outset here this morning. I think the availability of credit has been a tremendous asset to consumers in this country.

Mr. ZOROYA. It really has.

Senator DODD. Tremendous asset to them and of the countless people who really were precluded from buying consumer goods that they needed, because they didn't have the availability of cash. In some cases, it may have been their own fault. In others—in most of them it has not. It is just a question of the squeeze. The availability of credit has been a terrific resource for people and a terrific resource of business in this country. And it has allowed the retail market to expand and grow considerably, it seems to me, in the last generation or so, since the availability of credit, as we know it, has proliferated.

So when we talk about how best to do deal with it here, I should have made it clear at the outside, certainly from this Senator's standpoint, what we are trying to design is a system that not only makes credit available but make it available at an affordable cost for people, so it doesn't end up becoming strictly a very excessive profit maker for a few.

Again, I thank you all three for being here.

We have our last witness here, who distinguished colleague from Nebraska has been patiently waiting for. [Laughter.]

Mr. Kizer.

Senator EXON. Just like I wait at Hechinger's.

Senator DODD. Just like you wait at Hechinger's.

I want to hear what Mr. Kizer has to say about the price of nails in Omaha. [Laughter.]

If you would buy your nails in Omaha, you wouldn't have that problem. You could bring them back here.

Senator EXON. Right.

Senator DODD. Mr. Kizer, we welcome you to the committee, and you have been more patient than all to have waited here all day for an opportunity to share your thoughts with us. We are as anxious to hear your comments and views as we were our first witness, and again, I am fortunate to have with me a colleague from Nebraska, who has been helpful on countless occasions to this Senator and has been gracious enough to come on over here both this morning and this afternoon, and Jim, I know you may have some welcoming words for Mr. Kizer.

Senator EXON. Well, welcome, Mr. Kizer, Mr. Kennedy and Mr. Ross.

Mr. Chairman, these gentlemen are here from Omaha, representing a very high quality insurance company in Omaha, NE, Central States Insurance Co. They are quality people in the consumer insurance industry, especially credit cards. You will remember, Mr. Chairman, that several months I talked to you about what I thought was basically a consumer matter. We have an amendment that I hope we can put on this bill. So far it has received generally

favorable action and thought from the Members that I have talked to about it.

I would certainly say that while it is true that these gentlemen brought this matter to my attention, I still think that as far as I am concerned, this is a consumer protection matter and not a protection of insurance companies. It comes down to basically a situation of we are going to see more and more, I suggest, in the future, Mr. Chairman, of different types of insurance to protect consumers on the everincreasing volume of consumer credit, including credit cards. I think that is a good thing. I think it is important that it be competitive. I think it is important that nobody be gouging anyone else, and I simply say that I think the consumer has a keen interest here, because, generally speaking, a consumer in the credit card business obtains insurance not through that consumer's own direction or suggestion. It is usually offered to him in some form, either at or sometime after a transaction is made, in this particular case, on a credit card.

There is increasing evidence though, and I think this is a free enterprise system at work, which I applaud and hail, that there is going to be competition in this area. Competition is what keeps rates down and the best interests of the consumer's protection up.

There has been some indication, though, and some fear, as we see more and more of this type of coverage being offered, that the interests of the consumer might be sidetracked somewhere along the line with regard to a bank holding company who may wish to change to another carrier. If he wants to change to another carrier, because that is for the good of the consumer, then I think they should have a way to get that job done. If they are making a change that in some way reduces the coverage to the consumer, so that the intermediary, in this case, the holding company, would make more money, then we have a concern. So it is a very delicate and difficult situation. I don't think we are going to have any wholesale violations of consumers' interests, but I think this is the time, perhaps, when we are looking at credit cards, for us in the Congress to recognize that there is an area that could cause some problems and hurt the consumer in the future. So what we are trying to do with this amendment is to protect the consumer and still encourage intense competition among the various companies. There are several of them that provide this insurance. I want them to compete openly and fairly in the marketplace, so long as we have the best possible measure of protection for the consumer that we can have.

So with that, Mr. Kizer, I would like to have you proceed with your testimony. And thanks for coming here.

STATEMENT OF WILLIAM KIZER, CHAIRMAN, CENTRAL STATES HEALTH & LIFE INSURANCE CO., OMAHA, NE

Mr. KIZER. Thank you, Senator Dodd and Senator Exon. I think you just made my speech, and I thank you very much.

I am very pleased to be here today and to have such a gracious introduction.

Senator DODD. We will accept your testimony, by the way, Mr. Kizer, and if you want to abbreviate it.

Mr. KIZER. The good news, Senator, is that I can make my statement in about 5 minutes.

Senator DODD. Fine.

Mr. KIZER. The bad news is that the price of nails in Washington is about twice as high as it is in Nebraska.

Senator DODD. I know.

Senator EXON. I know that. [Laughter.]

Senator DODD. I know what to get him for Christmas next year. [Laughter.]

Mr. KIZER. With me today are John Kennedy, on my right, who is a senior vice president and general counsel, and Bill Ross, the senior vice president of our Direct Marketing Division at Central States.

Central States underwrites credit life, disability and involuntary unemployment insurance for bank credit cardholders.

The insurance program assures repayment to the bank in the event of the death, disability or unemployment of the insured cardholder. We market this insurance plan through regular mailings of the bank's credit card operation. To enroll, the credit cardholder must execute an insurance enrollment form similar to the one reproduced as attachment A to my statement. We currently offer this insurance program through financial institutions which have in excess of 12 million credit cardholders across the Nation.

In the statement which accompanied your introduction of S. 616, the Full Credit Card Cost Disclosure Act, Mr. Chairman, you stated your subcommittee would consider several issues, among them, whether it is appropriate to change credit card insurers without letting customers know. In the opinion of Central States, it is not only inappropriate for banks to change insurance carriers without adequate disclosure to consumers, it is also an unfair practice which adversely affects the interests of the cardholders who pay the premiums.

We are convinced that now some banks participating in a credit card insurance program have unilaterally transferred their insurance program from one carrier to another without prior notice or reenrollment or consent of the insured credit cardholders

Mr. Chairman, we do not question the right of a financial institution to offer this insurance or to change carriers, but we do believe that the variety of interests involved requires a high standard of disclosure and the reenrollment of cardholders.

Under such a program, the bank has a significant combination of economic interests. It extends the initial consumer credit. It is the policy holder and it is the payee of any insurance proceeds. It is also the producer of the insurance, receiving regular compensation from premiums paid.

Because of these multiple interests and the narrow insurance exemption carved out in the Garn-St Germain Act of 1982, we believe that notification and re-enrollment are essential, in order to assure adequate consumer protection when a bank unilaterally decides to change the insurance carrier.

Central States follows the practice of disclosure and re-enrollment in all situations where we are a replacement carrier. In our view, re-enrollment is necessary because companies and coverages differ. You cannot simply roll over the same policy. There are too

many variables, too many differences which could be material. Furthermore, there are too many possibilities for mistakes, which we do not find to be an acceptable business practice.

For example, re-enrollment is essential, in order to avoid the confusion and uncertainty in the minds of the cardholder, the bank and the new insurance company on whether, in fact, the cardholder has been notified, has specifically requested continued coverage, as well as the amount and the nature of his coverage.

As explained more fully in my statement, Mr. Chairman, we do make the following points:

A bank offering credit card insurance is in a unique position, since it extends the credit to the cardholder, contracts with the insurance company to provide the coverage, collects premiums from the credit cardholder to pay for the coverage, earns a commission on those premiums and is the ultimate beneficiary in the event of a claim made under the policy. The bank's interest, therefore, and those of the cardholder are not necessarily consistent and, indeed, may be in conflict.

Notice and re-enrollment is essential to protect the interests of cardholders in the case of any change of carrier, since that is the only sure way to assure that they are informed of the identity and stability of the new carrier, the nature, extent and the cost of the coverage and the terms and the conditions of the coverage spelled out.

In the original enrollment process, the cardholder designates who is to be primarily covered for life, disability and involuntary unemployment benefits and also the name of the additional cocardholder to be covered for life insurance benefits. This information is generally retained by the insurance company and not by the bank. Therefore, if there is a change of carrier, neither the new insurance company nor the bank can assure that the cardholder's specific choice will be preserved without re-enrollment.

The notice and re-enrollment process is a simple one which imposes little burden on the bank or the new insurance company, given the unusual circumstances which exist and the need to protect the insured.

Once again, Mr. Chairman, we do not challenge the right of banks to change insurance carriers. We simply believe Congress must act to assure that the offering of such insurance products is consistent with meaningful consumer protection, assurances of fair competition and sound banking practices based upon full disclosure.

A quick summary. We are concerned about bank card customers being billed for items they did not purchase. We are concerned about card centers switching customers' insurance to another carrier without customer consent. We are concerned about card centers sending cardholder money to an insurer not authorized by the cardholder. We believe these practices should be corrected in the manner just outlined through re-enrollment, and re-enrollment is synonymous with disclosure and with competition.

Mr. Chairman, we are here to provide full disclosure to any questions you may have. And thank you very much.

[Complete prepared statement of Mr. Kizer follows:]

Before the

Committee on Banking, Housing and Urban Affairs

United States Senate

Consumer Affairs Subcommittee

S. 616

The Full Credit Card Cost Disclosure Act

Statement of Central States Health and Life Company of Omaha

March 26, 1987

Mr. Chairman, members of the Subcommittee:

My name is William Kizer and I am Chairman and Chief Executive Officer of Central States Health and Life of Ohama. I appreciate the opportunity to appear before you this morning to address an issue concerning credit life, disability and involuntary unemployment insurance coverages sold by banks with their credit cards.

In the statement which accompanied your introduction of S. 616, the Full Credit Card Cost Disclosure Act, Mr. Chairman, you stated that your Subcommittee would consider several issues, among them, "whether it is appropriate to change credit card insurers without letting consumers know." In the opinion of CSO, it is not only inappropriate for banks to change insurance carriers without adequate disclosure to assure consumer protection, but it is also an unfair and unsound practice which adversely affects the interests of insurance companies issuing this type of insurance, the financial institutions who are the beneficiaries of the policies and the cardholders who specify the coverage and pay the premiums.

My company is proud of the fact that it has pioneered the offering of credit life, disability and involuntary unemployment insurance coverage in connection with bank credit card indebtedness, which is a fairly new consumer protection concept already receiving wide acceptance throughout the United States.

Under this program, a master policy is issued to the bank and individual certificates of insurance are issued to those of its credit cardholders who elect to participate in the insurance program. Monthly insurance premiums are collected through the regular billings of the bank's credit card plan, and the bank receives a portion thereof as compensation. The insurance program assures repayment to the bank's company of the credit card indebtedness of a plan participant in the event of death, disability or involuntary unemployment. The insurance plan is marketed through regular mailings of the bank's credit card operation. An interested credit cardholder must execute an insurance enrollment form similar to the one reproduced as attachment A to my statement.

Under such a program, the bank has a significant combination of economic interests. It extends the initial consumer credit, is the policyholder, and is the payee of any insurance proceeds. It is also the producer of the insurance, receiving regular compensation from premiums paid.

A disturbing development now exists in which some banks participating in a credit card insurance program have unilaterally transferred their insurance program from one insurer to another, without prior notice to, or consent of, their credit cardholders (the insured parties), and without insurance reenrollment by their credit cardholders.

We do not question the right of a financial institution to change underwriters, but we do believe that the variety of interests which banks have in credit related insurance requires the disclosure and reenrollment of credit cardholders.

As you are fully aware, Mr. Chairman, whether or not banks and bank holding companies and other financial institutions should be allowed to underwrite and sell insurance products has long been, and remains, a very contentious issue before the Congress and bank regulatory agencies. The right of bank holding companies to sell credit insurance is a carefully carved out exemption from the general prohibition on the sale of insurance by bank holding companies which was agreed to by the Congress in enacting the Garn/St Germain Act of 1982. Our company supported the exemption and, in fact, initiated the unemployment feature of the program. Congress determined that such exempt insurance sales should be permitted only where important public benefits can be shown to result from such an activity. This, in turn, requires careful consumer protection which can only result if notification and reenrollment is insisted upon by the Congress when a bank or bank holding company unilaterally decides to change the insurance carrier.

Because the practice of changing insurance carriers without notifying credit cardholders and reenrolling them in the new program is, in CSO's view, inconsistent with the clear thrust of the Garn/St Germain Act, we participated in the Federal Reserve Board's rulemaking in Docket R-0511 which dealt with a range of issues concerning the sale of insurance by bank holding companies. Despite our showing that the practice was totally inconsistent with the clear mandate of Congress in enacting the Garn/St Germain Act, the Board dismissed our request that its regulations be amended to require notice and reenrollment in the event of a change of insurance carrier. The Board rejected this request by stating:

> "The Board has been requested to impose a more stringent public benefits requirement by requiring bank holding companies that sell credit life insurance through affiliated underwriters to notify and reenroll all borrower/policyholders when changing underwriters. The Board believes that the policyholder's contract rights under state law provide adequate protection and that such a requirement is an unnecessary burden on bank holding companies not required under the "proper incident" standard of section 4(c)(8) of the Act."

The Board's objections are misplaced. The Bank Holding Company Act clearly establishes the Federal interest in matters affecting the insurance activities of bank holding companies. State law may affect various aspects of bank holding company activities, but Congress assumed the direct responsibility to set forth the general standards and limitations on those activities to ensure consumer safeguards and fair competition. Moreover, inserting a notice and reenrollment form in the monthly statements issued by banks to credit cardholders, when viewed in light

of the statutory standards promoting consumer protection and fair competition, is a requirement that imposes a necessary, not an unnecessary, burden on banking organizations.

Since the Board chose not to amend its regulations, we urge Congress to add the notice and reenrollment amendment, which is attachment B to my statement, to S. 616 when this bill is reported by your Subcommittee. The amendment preserves the balance, established by Congress in the Garn/St Germain Act of 1982, between the economic interests of banks and consumers, and of bank and nonbank insurors, in connection with credit insurance programs.

It is our position that notification and reenrollment should be required in all instances where there has been a change of insurance carrier for a number of reasons, including the following:

(1) A bank holding company offering credit card insurance is in a unique position since it extends the credit to the credit cardholder, contracts with the insurance company to provide the coverage, collects premiums from the credit cardholder to pay for the coverage, earns a commission on those premiums and is the ultimate beneficiary in the event that a claim is made under the policy. The bank holding company's interests, therefore, and those of the credit cardholder are not necessarily consistent and may be in conflict.

(2) If the Bank Holding Company Act were to be amended to require notification only where a change in the insurance carrier adversely affected the interests of the credit cardholder, it would require a subjective judgement by either the bank or the new credit card company, create a cumbersome two-tiered and perhaps discriminatory system for selling this type of insurance, and create additional costs and administrative burdens which would be obviated by requiring notification and reenrollment in the first place.

(3) Notice and reenrollment is essential to protect the interests of the credit cardholders in the case of any change of carrier since it is only by such a process that the fact of the change can be made known to the credit cardholder, the identity and stability of the new insurance carrier revealed, the nature, extent, and cost of the coverage made known, and the terms and conditions of the coverage clearly spelled out.

(4) In the original enrollment process, the cardholder designates who is to be primarily covered for life, disability and involuntary unemployment benefits and the name of the additional cardholder to be covered only for life insurance benefits. This information is generally retained by the insurance company, not the bank. Therefore, if there is a change of carrier, neither the new insurance company nor the bank can assure that the credit cardholder's specific choice will be preserved without reenrollment.

(5) Reenrollment is essential in order to avoid confusion and uncertainty in the minds of the credit cardholder, the bank, and the new insurance company on whether, in fact, continued coverage has been specifically requested, and the amount and nature of the coverage which is being contracted for.

(6) The notice and reenrollment process is a simple one which imposes little burden on the bank holding company or the new insurance company as is evidenced by the attached reenrollment form for a Payment Protection Information Plan. The entire process is accomplished through the regular monthly credit card mailing. The benefits to the cardholder of notification and the opportunity to reenroll far outweigh what little expense or inconvenience that is imposed on the bank or the insurance company.

Mr. Chairman, let me reiterate the CSO does not oppose the sale of credit life, disability and involuntary unemployment insurance, but, in fact, we supported the legislation which permitted it. Nor do we challenge the right of banks to change insurance underwriters. We believe Congress must act to assure that in offering such insurance products, it does so consistent with meaningful consumer protection, assurances of fair competition and sound banking practices.

Thank you for the opportunity to appear before you this morning, Mr. Chairman, and if there is any additional information we can can provide, or additional data which the Subcommittee would find useful regarding this issue of substantial importance not only to my company but to financial institutions who participate in our program and, most importantly, to the American consumer, we would be pleased to do so.

ATTACHMENT A

Payment Protection Information

During this Open Enrollment Period, payment protection is available to members through the optional Group Credit Card Insurance Program. This program provides you, the designated Cardmember, with the following benefits:

- **Life Insurance** — pays your unpaid account balance up to $5,000 if you or your named additional Cardmember should die.
- **Disability Insurance** — pays a monthly insurance benefit to your account if you become totally disabled for more than 30 days.
- **Unemployment Insurance** — pays a monthly insurance benefit to your account if you become involuntarily unemployed (loss of job, strike or lay-off) for more than 30 days.

Life and disability insurance benefits are payable up to the sum of your unpaid account balance at time of loss or $5,000, whichever is less. Unemployment benefits are limited to nine (9) monthly insurance benefit payments.

The cost is 59¢ per $100 of your outstanding balance. This charge is automatically included on your monthly statement. **EXAMPLE:** If your outstanding balance is $225, an insurance charge of $1.32 will appear on your monthly statement ($225 × $.0059 = $1.32).

Please complete the enrollment form on your payment envelope. Detach and return it with your payment. This Open Enrollment Period ends on your Payment Due Date. If you have previously enrolled in this program, it is not necessary to return the form.

members who are in good standing and under age 66 are eligible to enroll.* After your enrollment form has been processed, you will receive a personalized Certificate explaining all benefits and provisions of the Group Master Policy. Your insurance coverage begins on the Effective Date shown on your Certificate. Enrollment is optional and you are free to cancel at any time.

Benefits are based on your account balance at date of loss and do not include any amounts added to your account after your loss. Your monthly insurance benefit in the event of disability or unemployment is 4% of your account balance at time of loss. The maximum monthly insurance benefit is $200.

To qualify for Unemployment benefits, you must register with a recognized employment agency or your state unemployment office within 30 days after the date you become involuntarily unemployed.

Benefits are not payable for total disability which is the result of: normal pregnancy or childbirth; any intentionally self-inflicted injury; or a pre-existing medical condition. A "pre-existing condition" is one for which you saw or were under treatment by a physician or chiropractor both within the six (6) months before **and** the six (6) months after the Effective Date of coverage. Disability commencing after this six (6) month period is covered. Life insurance benefits are not payable for death in the event of suicide within six (6) months of the Effective Date of coverage.

Coverage under this program is currently not available to residents of AZ, HI, MA, ME, NC, NH, NJ, NY, OR, PA, SC, WY or to cardmembers residing outside the United States. For residents of CT and TX: please complete the form on your payment envelope or call our toll-free number and we will send you enrollment materials for the coverage available to you.

This coverage terminates at age 66.*

***Plan Modifications** — For residents of GA, MI and OK: cardmembers under age 71 are eligible to enroll and coverage terminates at age 71. For residents of WV: the named additional Cardmember must be your Spouse.

This program is offered, administered and underwritten by Central States Health & Life Co. of Omaha, Central States Indemnity Co. of Omaha and/or National Indemnity Company, all of Omaha, Nebraska. You may write to us at 96th & Western, Omaha, Nebraska 68114.

For more information or to file a claim, call Central States toll free: 1-800-445-6500

Form 8120 1 87 M 1

Policy Forms 10479-11008 (c) - 11185

...whether you would like to have your [illegible] payments made for you in the event of your death, disability or involuntary unemployment.

Please Complete, Sign And Return The Form Below With Your BankAmericard Payment.

DETACH HERE BEFORE MAILING

YOUR REPLY REQUESTED

☐ **YES** I wish to protect my account balance in the event of death, disability or unemployment by enrolling in the Group Credit Card Insurance Program offered by Central States of Omaha. I understand that enrollment is optional, that I am free to cancel at any time and that the cost is 50¢ per $100 of my outstanding balance. My signature below means that I have read and understand the Application of Cardmember information on the reverse side.

SIGN HERE TO ENROLL (Either Cardmember may sign) X	Date

OR

☐ **NO** I do not wish to enroll in the insurance program that would protect my account balance in the event of death, disability or unemployment.

SIGN HERE TO DECLINE (Either Cardmember may sign) X	Date

Fill In Your [illegible] Number(s) To Be Insured.

VISA ☐☐☐☐-☐☐☐☐-☐☐☐☐-☐☐☐☐

MC ☐☐☐☐-☐☐☐☐-☐☐☐☐-☐☐☐☐

Print name of designated Cardmember to be covered for Life, Disability and Involuntary Unemployment benefits.	Birthdate Mo. Day Yr.
Street Address	
City State ZIP	

Print name of additional Cardmember also to be covered for Life Insurance benefit.	Birthdate Mo. Day Yr.

[illegible] Side For Application of Cardmember [illegible] L.D. #18

APPLICATION OF CARDMEMBER

You are applying for credit insurance described on this envelope and authorizing [illegible] to add the charges for insurance to your account each month as they become due. You have the right to stop this authorization. Your signature to enroll (on the reverse side) means you agree that:

1. You are eligible for involuntary unemployment insurance only if you are working for wages or profit 30 hours a week or more. If you are not, you will not be insured until you return to work.
2. You are insured only for your actual credit card balance. You are not insured for any unused credit which may be available to you.
3. Each month on your statement date the insurance charge is calculated by multiplying the outstanding balance of your credit card account (up to a maximum of $5,000) by $.0069. This insurance charge will be shown on your credit card account statement and included in your New Balance.

We can change the rate later on. But if we do, we will let you know in advance. The new rate will apply only to charges for insurance made after the date of the rate change.

4. Your named additional Cardmember is not eligible for disability or involuntary unemployment insurance.
5. Neither you nor your named additional Cardmember are eligible for insurance after you have reached your 66th birthday, and insurance will also stop when you reach that age.*

DISABILITY INSURANCE MAY NOT COVER CONDITIONS FOR WHICH YOU HAVE SEEN A DOCTOR OR CHIROPRACTOR IN THE LAST SIX MONTHS. (Refer to "Total Disabilities Not Covered" in your Certificate for Details.)

Policy Forms [illegible] Rev. Ed. L.D. #18

THE OPPORTUNITY TO ENROLL IS BEING PROVIDED BY [illegible] AS MASTER POLICYHOLDER. THIS PROGRAM IS OFFERED BY CENTRAL STATES HEALTH & LIFE CO. OF OMAHA, CENTRAL STATES [illegible] OF OMAHA AIRWAY RATING CO., [illegible] COMPANY, ALL OF OMAHA, NEBRASKA.

[illegible]

*See brochure for Plan Modifications.

PLEASE NOTE

1. Please read the accompanying brochure about the optional Group Credit Card Insurance Program and then indicate on the attached form whether or not you wish to enroll. *If you have previously enrolled in this program, it is not necessary to return the form above.*

2. After completing and signing this form, return it with your payment. This Open Enrollment Period ends on your statement's Payment Due Date.

3. Be sure to detach and enclose the top portion of your account statement with your monthly payment.

4. Please sign your check and write your account number on it. (Please do not mail cash.)

ATTACHMENT B

Amendment to S. 616

The Full Credit Card Cost Disclosure Act

At the appropriate place in S. 616, insert the following:

REPLACEMENT INSURANCE COVERAGE

Sec. ---. Section 4(c)(8)(A) of the Bank Holding Company Act of 1956 (12 U.S.C. 1843(c)(8)(A)) is amended by inserting before the semicolon at the end thereof the following: "except that any bank holding company or subsidiary or affiliate thereof offering such insurance for an insurance company in connection with revolving forms of indebtedness, including credit card indebtedness, shall, prior to substituting one insurance company for another, provide to each insured debtor notice of the substitution, a description of the amount and terms of the coverage to be substituted, a description of any benefit reductions or limitations, and shall specify the premium charges for the substituted insurance and obtain a new written request for the insurance signed by the insured debtor."

Senator DODD. Well, I thank you for a very thoughtful statement. I presume you were here this morning when the representative of the Federal Reserve Board was here, and I raised, I hope I raised adequately the question which you have raised in your testimony. You heard, of course, Ms. Seger respond that they had responded negatively to the inquiry originally, in terms of the business practice, Jim, I would say to you——

Senator EXON. Yes, I was here then.

Senator DODD. And I raised the question about the consumer impact, which is what Senator Exon has discussed in his comments and what you have talked about in your statement here. That will be of tremendous help to us, I think. They have been supportive of legislation, generally, in this area that we have talked about here, and I think, if I interpreted her response correctly, they really didn't look at the consumer aspect of it in making that original decision. My feeling was that they would look anew, if you will, at the implications for it. So we will follow this closely. I know the deep interest that Senator Exon has in this. He has spoken to me on numerous occasions about it already in preparation of these hearings. And as we move along, we will do our very best to see to it that we can take care of your concerns and your interests.

We have been blessed with the presence of my colleague from New York, who I would point out, despite the inclement weather in the northeast over the last several weeks, looks inordinately healthy. [Laughter.]

He says he was in Syracuse. Well, I don't know what it is like in Syracuse. I know what it is like in Hartford these days. It's been raining. Nonetheless, he has a good color and has been very interested in this legislation. As I mentioned earlier this morning he was unavoidedly detained at his alma mater, as I understand it, Syracuse University, and could not be here. But one of the bills that has been under discussion is a piece of legislation introduced by Senator D'Amato. He has had a strong interest in this matter, going back to his very first days when he arrived in the Senate and has come by here this afternoon.

And Al, before we go any further, I would like to give you an opportunity to make any comments you'd like, and if you have any questions for our witness here.

By the way, I left the record open for all of the witnesses for any written questions you may have for them as part of the record, to be available.

Senator D'AMATO. Mr. Chairman, thank you. I commend you on your powers of observation and want you to know that it was in the quest of consumer legislation and interests that I traveled to the various parts of our country to see if the credit card charges were any lower. [Laughter.]

I want you to know that my children made good use of the credit cards in our swing through the south. [Laughter.]

And that, unfortunately, the credit card charges were not much lower, particularly in the State of Florida.

Let me say, seriously, Mr. Chairman, that No. 1, when it comes to the interests of consumers, Senator Christopher Dodd has been in the forefront, whether it be in the area of check cashing, the undue delays, whether it be in the area of consumer interests, and

this has not been a passing matter of interest to the Senator. He has remained steadfast. He has remained open, though, willing to listen to all sides.

I join him in his efforts, because it is my very strong feeling that while interest rates have come down by every measurable standard, that the savings that could and should have been passed on to consumers, just have not taken place. I think it was wrong. I think that it was an opportunity that goes well beyond the free enterprise system, that indeed, for a longer period of time, there was a conspiracy. One might say was that a conspiracy violative of the law? Well, by way of action, when all the major money center banks at various points in time had little, if any difference with respect to the interest rates that they charge, there is no doubt in my mind that they concluded they had a pretty good deal. So lets not let the competitive forces work by cutting interest rates. We are all doing well. Let's not seek a better share of the market by reducing those rates.

That has, to a certain extent, that conduct has been modified. It's changed. There have been some who become—Manufacturers Hanover was the first of the large money center banks to break with that and dropped its interest rates two points. Some of our larger institutions, thrifts, began to put pressure on, began to advertise very aggressively.

So we have seen those rates come down somewhat. I think they can still do better. But there is no doubt in my mind, were it not for the activities of the chairman and others, that the rates would be much higher than they are today.

I commend Mr. Kizer for his incisive, concise testimony. I would ask, Mr. Chairman, that I be permitted to put the balance of my remarks in the record. And I stand ready to work with you and, hopefully, framing out legislation and bringing it to a fruition that will give the consumers a better shot.

Senator DODD. I thank my colleague. I would have expected nothing less. He has always been helpful and cooperative on these matters.

Jim, do you have questions?

Senator EXON. No, I have no questions. I just want to thank Mr. Kizer and his associates for coming here and outlining what I think is a very reasonable proposal in support of the amendment that I have suggested to you. I want to thank you, Mr. Chairman, for your being very forthcoming on these matters, and we think you do an excellent job as chairman of this important banking committee, and we look forward to working with you in the future, hopefully, resolving the problem that has been brought up by Mr. Kizer and the very interesting hearing that I was able to sit in parts of early today.

Thank you very much.

Senator DODD. I thank you. Thank you, Mr. Kizer, very much.

Mr. KIZER. Thank you, Senator.

Senator DODD. This subcommittee has completed this hearing. The testimony has been valuable. I can't say for certain what the dates will be for a markup. It won't be anything immediate. We've got a major banking conference coming up in the next several weeks. That will take an inordinate amount of time of this commit-

tee, but I hope it would be sometime in the next month or the month after, that we would get to a markup. In the meantime, of course, we will be working with those institutions that were represented here today from both the private and public sector, consumer groups and the like, to try and put together a piece of legislation that makes sense for all, and most importantly, the consumers of this country who depend upon credit.

We thank you all.

This subcommittee stands adjourned.

[Whereupon, at 3:30 p.m., the hearing was adjourned.]

[Response to written questions and additional material supplied for the record follow:]

Sears, Roebuck and Co.
Corporate Governmental Affairs
Sears House
633 Pennsylvania Avenue, N.W.
Suite 600
Washington, D.C. 20004

RANDOLF H. AIRES
VICE PRESIDENT

202 / 737-4900

May 4, 1987

The Honorable Christopher Dodd, Chairman
Subcommittee on Consumer Affairs
Committee on Banking, Housing & Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Sears is submitting the following comments on proposed credit card disclosure legislation to the Senate Banking Subcommittee on Consumer Affairs for inclusion in the hearing record.

Sears, Roebuck and Co. has a 75 year history as a provider of consumer credit through installment credit, SearsCharge revolving accounts and more recently through the Discover Card. Sears is committed to providing its credit customers with good value and convenience as well as helpful information regarding the proper use of credit.

As a natural extension of this commitment to the consumer, Sears supports legislative efforts which have the effect of ensuring that consumers are provided with useful information with which to shop for credit.

Meaningful disclosures in mailed solicitations for credit will enable consumers to identify a credit card that offers the greatest value for their individual credit needs. Since value, as it relates to the extension of credit, means something different to each credit customer depending on individual credit card usage, proposals to disclose the essential cost components of a credit card are far preferable to proposals which would impose restrictions on a creditor's ability to price credit services. Examples of such restrictions are federal interest rate caps and mandated balance calculation methods.

Since the goal of any credit card disclosure legislation should be to provide easily understood, simplified disclosures of key terms to assist consumers in making informed credit shopping decisions, less meaningful disclosures should be avoided.

While S. 616, meets the objective of providing the consumer with the essential cost of credit terms -- annual fee, annual percentage rate, and grace period -- the bill goes further to require additional unnecessary disclosures. In addition, the documents and instances in which such disclosures are required are broad and undefined. The lengthy and complex disclosures -- such as the disclosure of the balance calculation method -- may hinder and even discourage effective comparison shopping, while imposing unacceptable burdens on card issuers.

The attached memorandum covers the specific issues raised by the disclosure proposals contained in the Senate bills. Please include it in the hearing record with this letter.

The House Banking Committee is currently considering two bills -- HR 1086 and HR 244 -- which meet the basic objective of providing consumers with simplified cost of credit information in order to assist the consumer in shopping for credit.

Sears supports HR 1086 and HR 244 and urges the Senate Banking Subcommittee to consider and adopt one of these approaches.

Sincerely,

Randolf H. Aires

ATT.

SPECIFIC ISSUES RAISED BY THE DISCLOSURE PROPOSALS

I. NOMINAL ANNUAL PERCENTAGE RATE, ANNUAL FEES, AND WHETHER OR NOT THERE IS A GRACE PERIOD SHOULD BE THE FOCUS OF MEANINGFUL DISCLOSURE LEGISLATION:

The purpose of any disclosure legislation should be to provide consumers with meaningful cost information with which to shop for credit. This purpose can be accomplished by providing consumers with essential cost information in mailed solicitations.

The nominal APR, annual fee, and whether or not there is a grace period are the most significant cost components of credit transactions. The initial disclosure of these items would provide consumers with meaningful information with which to make a simple cost assessment, thereby assisting consumers in choosing the best credit card to fit their credit needs.

"Other charges" can be construed broadly to include fees such as late fees or returned check charges. Consumers generally do not choose a credit card based on these penalty fees. Current requirements of the Truth in Lending Act provide disclosure of these terms before the first transaction is made on the credit card. Sears believes this is the most appropriate time to make such disclosures.

Disclosures of the nominal APR, annual fee, and whether or not there is a grace period will ensure simplified and meaningful disclosure for consumers.

II. MAILED SOLICITATIONS ARE THE PROPER DISCLOSURE VEHICLE:

"Take-one" applications generally made available to consumers in a retail establishment, catalog applications and certain other solicitations, including magazire advertisements should not be subject to new disclosure requirements.

There are several practical problems associated with making advance disclosures in advertisements, particularly for a national retailer such as Sears. SearsCharge must comply with 50 different state laws governing credit rates and terms. Full disclosure of the varied state rates and terms in an advertisement printed in a national magazine would be complicated and extensive and as a result, may actually create additional confusion for consumers.

Similar operational problems arise with regards to disclosures in "take-one" applications. Again, full disclosure of the varied state rates and terms in a "take-one" application would be lengthy and complex and therefore, would be inconsistent with the legislative goal of a truncated summary of significant credit terms.

Finally, terms disclosed in an advertisement or "take-one" application may change and material may become dated. Outdated information -- regardless of whether or not it is "dated" on the application--would confuse rather than enhance consumers' understanding of credit costs.

If "take-ones" are to be covered at all, a simple disclosure on the application which provides an address or phone number for the creditor and says that the consumer should check with the card issuer on certain terms prior to becoming obligated, should be satisfactory, without any "dating" requirements.

III. LEGISLATION SHOULD AMEND SECTION 143 OF THE TRUTH IN LENDING ACT:

Section 143 of the Truth in Lending Act currently provides guidelines regarding proper disclosure in advertisements which promote open-end credit plans. Since mailed solicitations are similarly designed to promote the extension of consumer credit, any legislation to require initial disclosure of credit terms in promotional materials should appropriately amend section 143.

Should Congress decide it is necessary to create an entirely new section of the Truth in Lending Act dealing with disclosure, it is essential that at the same time inconsistencies between that new section and the existing advertising section be resolved. These resolutions are necessary in order to help credit grantors know with certainty what disclosures are necessary and assures that the disclosures and advertisement requirements do not create an even more confusing situation for consumers.

IV. DISCLOSURE LEGISLATION SHOULD PROVIDE FOR SOME FLEXIBILITY AMONG CREDITORS:

Disclosure legislation should provide creditors with the necessary flexibility to either disclose to the consumer only the rates and terms that apply to that particular consumer at the time of solicitation or, to disclose the rates and terms offered by the creditor to all consumers in the various states in which the creditor solicits new accounts.

In addition, any disclosure legislation should provide a creditor with the option of satisfying the disclosure requirement by including a copy of the credit cost components contained in the credit agreement which meets the full disclosure requirements of the Truth in Lending Act.

V. "TABULAR FORMAT" DISCLOSURE REQUIREMENTS SHOULD BE REPLACED BY SIMPLE "CLEAR AND CONSPICUOUS" STANDARD:

Specific disclosure formatting requirements could lead to protracted and costly litigation and civil liability for card issuers due to minor technical formatting violations.

In addition, tabular formatting may not always be the most clear and simplified way to make the required disclosures. There may be circumstances in which a short narrative disclosure would be more meaningful to consumers.

Therefore, instead of specific tabular formatting requirements, legislation should only require that disclosures be "clear and conspicuous."

VI. FEDERAL PREEMPTION STANDARD:

Without a federal preemption standard, disclosure compliance will be unduly complicated for national and regional card issuers who could be forced to comply with differing state and federal disclosure requirements.

Moreover, differing state standards would make it difficult, if not impossible, for consumers to select among cards being offered by creditors operating in different states or regions.

Therefore, in order to ensure uniformity, a federal preemption standard should be included in credit disclosure legislation.

QUESTION FROM SENATOR ALFONSE M. D'AMATO
BANKING COMMITTEE HEARING
APRIL 21, 1987

If Congress were to place a ceiling cap on credit card interest rates, what effect would this have on present cardholders? What about first-time applicants?

ANSWER FROM ELGIE HOLSTEIN
DIRECTOR, BANKCARD HOLDERS OF AMERICA

In 1986 seven states enacted legislation to help provide greater protection to cardholders from unfair and costly credit card practices. One of those states, Connecticut, imposed a fixed 15% ceiling on credit card interest rates. Before the Governor signed the bill, a rate war broke out among the card issuers in that state. Cardholders have clearly benefitted from this new competitiveness in bankcard interest rates. Equally important, none of the gloom-and-doom predictions about the results of such action has come to pass. Credit has not dried up in Connecticut, card operations have not been moved out-of-state, and banks are certainly not losing money.

Whate about first-time card applicants? Just as in the cases of automobile loans and personal loans, it is true that lower credit card profit margins may force greater scrutiny by the banks of credit card applications, especially those they send out through mass mailings on a so-called "pre-approved" basis. First-time applicants with a reasonably stable credit background -- a steady job, an absence of heavy debt, etc. -- will continue to qualify for cards. Reducing the availability of cards to unemployed teenagers, inmates, children, and household pets seems to be a small price to pay for lower credit card rates for everyone else.

RESPONSE TO WRITTEN QUESTIONS OF SENATOR D'AMATO FROM
MARTHA R. SEGER

Question: In your testimony you state that "the Board has endorsed the principle that consumer loans are most fairly and efficiently allocated where there are no regulatory constraints on interest rates." I could not agree with you more. However, it is unconscionable that issuers are gouging the public by charging rates in excess of 22%! What do you recommend to lower interest rates charged on credit cards so they are more in line with other common rates? Or, do you think it is unimportant for credit card interest rates to be in the same range as other common rates?

Answer: Before setting forth my recommendations on lowering credit card interest rates, I would like to make two points. First, while it may be true that some financial institutions charge rates that exceed 22 percent, the average rate charged by all bank card issuers is significantly lower--currently (most recent data are for November 1986) slightly above 18 percent. Second, credit card interest rates, in my view, should not be expected to be "in the same range as other common rates." While the average rates for other forms of consumer credit are currently generally less than the rates for credit card borrowings, credit card lending involves several factors that are unique and that impose costs that do not exist in other credit programs. For example, credit card programs involve multiple small dollar transactions, the issuance of periodic statements, and the possibility of fraud losses from lost or stolen credit cards. Moreover, unlike other consumer credit, most credit card plans provide a grace period for purchase transactions, thus consumers that pay their outstanding

balance in full each month avoid incurring finance charges. Consequently, only a portion of outstanding credit card balances earn interest, yet creditors incur costs associated with making these non-interest earning funds available to the consumer. As a result, I would expect the rate for credit card programs to be higher than other types of unsecured consumer credit. In fact, that is precisely the case; the average bank credit card rate is in the neighborhood of 18 percent while the average interest rate for 24-month, personal unsecured loans at commercial banks is around 14.1 percent. In light of the many factors and considerations faced by individual institutions offering credit cards, I would not conclude that the average bank credit card rate is out of line with their costs or other consumer rates such as the rate for personal unsecured consumer credit.

My recommendation for addressing concerns about credit card interest rates is to facilitate the competition that I believe already exists in the credit card market. Requiring credit card issuers to provide consumers with additional information that will allow them to easily compare credit card programs would be useful in this regard. For example, the legislative proposals requiring the disclosure of the annual percentage rate, the annual fee, and the grace period in credit card solicitations would benefit consumers. On the other hand, the Congress should not require disclosures that are too lengthy

or complicated, which could overload and possibly confuse rather than help the consumer. Requiring straightforward, simple disclosure of a limited number of terms should enable consumers to more readily compare credit card programs and select the program that is best for them. This in turn will enhance competition in the credit markets.

Consumer Federation of America

QUESTION OF SENATOR ALFONSE M. D'AMATO

In your t·stimony, you state that interest rates on credit cards will not decline without congressional action or, as in Connecticut, without state action. Will you explain why you fell that the market place will not work efficiently and allow rates to decline?

RESPONSE OF ALAN FOX, CONSUMER FEDERATION OF AMERICA

The recent history of credit card interest rates suggests that the marketplace, at least as now constituted, will not reduce credit card rates. Although the cost of funds has generally declined over the past five years, and although attention has been focused on credit card rates for two years or more, there has been no substantial move toward lower rates.

One reason for the "stickiness" of credit card rates is that consumers are not provided the information they need in order to exercise market discipline. Many factors need to exist if a market is to work efficiently. One factor clearly missing from the market for credit cards is adequate information for buyers of the service.

While improvements in consumer disclosures are clearly needed, they may not be sufficient to make the credit card market work. The major credit card issuers appear to be holding the line against all pressures to reduce rates. As our written testimony indicates, there is clear evidence that those who profit from high rates are prepared to use any means necessary to keep rates high, including the issuance of economic threats against competitors or potential competitors that offer lower rates. As long as the major issuers are willing to hold the line and as long as they are willing to use any tactics necessary to fight off perceived threats, the market will not work efficiently and rates will not be reduced.